LINKING SOUTH AND EAST ASIAN ECONOMIES: MARKETS AND INSTITUTIONS

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December 2009

Section 1: India's Trade and Investment Policies

India's present cycle of economic reforms were triggered in 1991 by an external sector balance of payments (bop) crisis. There was an earlier cycle of reforms that has been described as reforms by stealth.[1] This dates to the second half of the 1970s and involved trade liberalization, as well as elements of industrial deregulation. However, this first cycle was more piece-meal and ad hoc and wasn't comprehensive as the second cycle, introduced in 1991.

Before discussing reforms since 1991, one should begin by asking what one means by economic reforms. Sometimes expressions like first generation and second generation are also used, suggesting that first generation reforms were introduced in the first post-1991 flush and that the second generation is what awaits us now. Unfortunately, the expressions first generation and second generation are never very precisely defined. However, two overlapping interpretations are possible. First, first generation refers to reforms that concern the external sector – elimination of quantitative restrictions (QRs) on exports, rationalization and elimination of export subsidies and their replacement by a system of export incentives[2], reduction in import duties, a market-determined exchange rate with a convertible rupee, a liberal policy on foreign institutional investments and opening up to foreign direct investments (FDI). On each of these, reforms have already been introduced, or there is a time-frame for their further introduction, although external sector reforms are also linked to negotiations, multilateral, regional or bilateral. They cannot always be introduced unilaterally. In contrast, second generation reforms concern the domestic economy, although a neat water-tight compartmentalization between the domestic and the external isn't always possible. Understandably, political economy considerations and vested interests are stronger in domestic economic reforms, compared to the external. Second, one can also interpret the first generation as reforms that concerned and were under the purview primarily of the Centre, or the Union government. In contrast, in a federal setup, second generation concerns reforms that have to be introduced at the State-government level.[3] Thanks to the first generation having been implemented, the focus of policy change has thus shifted from the Centre to the States. The cutting, and the blunting edge, of reforms thus lies at the level of the States and different States have reacted differently to liberalization. What is also of note is that most product market policies are with the Centre, while most factor market (labour, land) policies are with the States.

On the first generation, that is, reforms in the external sector, the following points can be made. First, customs tax revenue as a share of total tax revenue has declined from 32.1% in 1995-96 to 17.2% in 2008-09, also mirroring a shift in tax revenue from indirect to

[1] See, for example, *India: The Emerging Giant*, Arvind Panagariya, Oxford University Press, 2008.
[2] Export incentives are WTO-compatible. Even when WTO-compatible, trading partners can subject export subsidies to countervailing duties.
[3] The Seventh Schedule to the Indian Constitution sets out a Union List, a State List and a Concurrent List.

direct taxes.[4] From 3% of GDP in 1995-96, customs revenue declined to 2% of GDP in 2008-09. Second, the average collection rate has declined from 29% in 1995-96 to 10% in 2007-08. However, higher-than-20% collection rates exist for chemicals, man-made fibres and metals. Third, the peak basic customs duty for non-agricultural products is now 10% and has been at that level since 2007-08. There is a difference between statutorily declared customs duties[5] and actually applied rates, both because there can be countervailing and special additional duties and because of exemptions. Hence, collection rates are a better indicator. While import duties have been reduced for manufactured products, they continue to be high for agriculture.[6] Even within manufactured goods, import duties tend to be high for the category described as consumer goods, automobiles being an extreme case in point. Fourth, there is an avowed intention of reducing import duties to ASEAN levels, with a time-frame not quite specified. Fifth, quantitative restrictions (QRs) have ceased to exist since April 2001[7], both on exports and imports. They primarily remain on environment, health and safety grounds. Everything else is on what is called OGL (open general license). OGL is actually an oxymoron, since OGL means one doesn't actually require a license for exports or imports. However, off and on, some items continue to be canalized. That is, they can only be traded through designated state trading organizations. Examples are cereals, pulses, edible oils, fertilizers and petroleum products. Sixth, there has been a progressive transition from WTO-incompatible export subsidies to WTO-compatible export incentives. A digression on the tax reform agenda is in order. This has both a direct and an indirect tax component, and the latter includes import duties. The broad shape of indirect tax reform is clear and has been set out. There should be a combined goods and service tax (GST), with service sector taxation integrated into a VAT (value added tax) framework instead of being a tax on turnover. This will be accompanied by a withdrawal of all other taxes like central excise, central sales tax, octroi, State-level sales tax, entry tax, stamp duties, transportation taxes and so on. All that has happened at the moment is a limited VAT, in the sense of unification of State-level sales tax, and the time-frame for introduction of a GST is April 2010 onwards. A GST is also required to make the export incentive system WTO-compatible, introduce appropriate countervailing duties and allow better defence against anti-subsidy and anti-dumping investigations. Seventh, the exchange rate is now market-determined. The rupee has been convertible on the current account since 1994 and there has been progressive easing of capital account restrictions. Eighth, the policy on foreign institutional investment (FII) has been liberalized. Ninth, the policy on foreign direct investment (FDI) has also been liberalized. Barring two caveats, FDI in manufacturing is free in the sense that there is automatic approval[8]. These two caveats are for instances where an item is reserved for production by the small-scale sector[9] or when there is a prior joint venture or technology transfer agreement with an Indian partner. FDI in agriculture is closed, but is also closed for the domestic private corporate sector. FDI in services is half-open and half-closed, with sectoral equity caps. Liberalization in some of these half-open and half-closed areas are often mired in controversy and debate, retail trade, media, banking, insurance, telecom, mining, civil aviation and real estate being cases in point.

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[4] Unless otherwise stated, all figures in this paragraph are from *Economic Survey, 2008-09*, Department of Economic Affairs, Ministry of Finance, Government of India. India follows the fiscal year system, from 1st April to 31st March of the next year.

[5] These are not rates bound at WTO. Those are higher.

[6] At the Uruguay Round, India offered bindings of 100% on commodities, 150% on processed products and 300% for edible oils. For agriculture, the simple average bound rate is now 114.8% and the bindings range from 25% on raw hides, skins and leather to 213% on fats and oils. See, *WTO Negotiations on Agriculture and Developing Countries*, Anwarul Hoda and Ashok Gulati, Oxford University Press, 2007.

[7] India lost a dispute at WTO on retention of QRs on balance of payments grounds.

[8] The phrase automatic approval is yet another instance of an oxymoron.

[9] If foreign equity is more than 24%, specific approval has to be sought.

There is no dearth of reports that are bullish about Indian growth prospects, some external, others internal or endogenous. Such a recent one states, "India now has the second fastest growing large economy in the world, surpassed only by China. Its per capita income approached $1,000 in 2007, when the economy exceeded $1 trillion for the first time. While still home to the largest number of absolute poor and with average per capita incomes only a ninth of the global average, India has just been classified as a lower middle income country, a far cry from the 1970s, when it was still one of the world's poorest countries. India today is home to many world-class corporations that enjoy global brand recognition and are busy expanding overseas as top global companies."[10] Some of these are not concerned with the overall economy, but concentrate instead on segments like out-sourcing and software exports.[11] In this list of bullish reports, the most widely quoted continues to be Dominic Wilson and Roopa Purushothaman's 2003 paper, better known as the first Goldman Sachs BRIC (Brazil, Russia, India, China) report. Much of the spectacular increase in the BRIC report happens after 2020, not before. The Indian real GDP growth projected in the BRIC report is much lower than what is prevalent internally, within the country. For instance, the BRIC report has average real Indian GDP growth of 6.1% from 2005-10, 5.9% from 2010-2015 and 5.7% from 2015-2020.[12] If there is disagreement between these external reports and those that emanate from within the country, that is primarily about this trend rate of growth of 6% or thereabouts, with an emphasis on the trend, as opposed to year to year fluctuations. Since reforms are equated with post-1991 developments, most external projections assume that 6 to 6.5% is the base-line rate of growth now. The key question is whether there has been another structural break in 2003-04, with a base-line trend growth of 8% or thereabouts. There are several reasons for such a belief. First, the savings rate has increased. In 2007-08, the savings rate was 37.7% and the investment rate was 39.1%.[13] Second, the incremental capital/output ratio (ICOR) is now around 4, which suggests that real growth of 9% is eminently doable. There is yet another change that is sometimes ignored, at least in this context. The share of agriculture and allied activities in GDP is declining and that of services is increasing. What is pertinent is that the service sector tends to have a lower ICOR. That apart, if agriculture is growing relatively slowly and services is growing relatively fast, the sectoral shift from agriculture to services itself jacks up GDP growth as a statistical inevitability. Third, the effect of export growth on GDP growth is perhaps not always explicitly recognized. Fourth, while the demographic dividend and India's demographic transition is recognized, its impact on GDP growth is not always factored in, the BRIC report being an exception. Growth projections are thus based on capital inputs, ignoring the labour component and the Indian labour force is expected to grow at just below 2.5% a year between now and 2020. This labour contribution should itself add a clear percentage point to GDP growth, problems of education, skills and morbidity notwithstanding. Fifth, the population is young, with a median age of 24. This does things to entrepreneurship that we imperfectly understand. One should not therefore be surprised if GDP growth turns out to be something like 9% between 2010 and 2015 and accelerates to 10% between 2015 and 2020, ignoring the effect of exchange rate changes.

[10] *India 2039: An affluent society in one generation*, Emerging Markets Forum and Asian Development Bank, 2009.

[11] Thomas Friedman's *The World is Flat: A Brief History of the Twenty-first Century*, 2005, is an example.

[12] There is a component of rupee appreciation that other projections often do not factor in and this adds around 30% to the per capita income increase.

[13] *Economic Survey, ibid.* This is at current market prices. Figures at constant market prices are slightly different.

However, this section is not concerned with "success" in overall GDP growth or poverty reduction, but with "success" that pertains to external sector reforms. These can quickly be listed as follows. The slowdown since September 2008 is something we will comment on later. First, the export/GDP ratio has increased from 5.8% in 1990-91 to 14.1% in 2007-08 and the import/GDP ratio has increased from 8.8% in 1990-91 to 21.9% in 2007-08.[14] Trade insularity is much lower. Second, since 2002-03 and before the current slowdown, exports of goods have grown every year by more than 20% in US dollar terms, barring 2004-05, when they increased by more than 30%. Third, India's share in world merchandise exports has increased from 0.5% in 1990-91 to 1.1% in 2007-08. Fourth, exports of services have grown by almost 30% in US dollar terms and India's share in world service exports is around 2.5%. In 2007-08, software accounted for 44.7% of service sector exports. There was even a current account surplus between 2001-02 and 2003-04. Fifth, all debt indicators (short-term debt as share of total debt, debt/GDP ratio, short-term debt/foreign exchange reserves, debt/service ratio) have improved.[15] Sixth, before 1991, annual FDI inflows were limited, in the neighbourhood of 100 million US dollars. FDI inflows were 8.9 billion US dollars in 2005-06, 22.8 billion in 2006-07 and 34.4 billion in 2007-08. Portfolio investments are also considerable, as are outward FDI flows from India.[16] Seventh, foreign exchange reserves have increased. They were US $ 5.8 billion in March 1991. In May 2008, they were US $ 314.6 billion. There is an internal debate about these reserves being sub-optimal in the sense of being excessive, and India's exchange rate policy. But for present purposes, we need not get into that.

Table 1 shows some "success" indicators for the external sector, with a focus on recent years, that is, since 2000-01.[17] The commodity composition of exports (goods) shows some changes since 2001-01. The share of primary products in the export basket declined a bit from 16.0% in 2000-01 to 15.1% in 2006-07. The share of manufactured products also declined from 78.8% in 2000-01 to 68.6% in 2006-07. And the share of petroleum and products in the export basket increased from 4.3% in 2000-01 to 15.0% in 2006-07. There was a change within the manufacturing category too. Light manufactured items like textiles and garments, gems and jewellery, leather and leather manufactures and handicrafts declined in importance. But the share of heavy manufactures like engineering goods increased from 15.7% in 2000-01 to 23.3% in 2006-07. Within the import (goods) basket, the share of fuel has been almost flat at around 33%. But the share of capital goods increased from 10.5% in 2000-01 to 15.4% in 2006-07 and the share of pearls, precious and semi-precious stones declined from 9.6% in 2000-01 to 4.1% in 2006-07. In the services export category, it is not just software exports that have grown fast. So have non-software services. For example, business services accounted for 2.1% of the service export basket in 2000-01, but the share increased to 24.1% in 2006-07. Mirroring this, in the services import basket, the share of business services increased from 7.0% in 2000-01 to 31.9% in 2006-07. FDI discussions tend to focus on inward FDI. However, outward FDI from India has also increased and was 14.4 billion US dollars in 2006-07.

[14] *Economic Survey, ibid.* Petroleum figures prominently in both the export and the import basket. The latter is known, but the former is not often appreciated.
[15] In December 2008, the total external debt was 230.8 billion US dollars.
[16] There are data problems is reporting these accurately. However, in the last three years, outward FDI has been of the order of around US $ 15 billion.
[17] Unless otherwise stated, data are from *Economic Survey, ibid.*

Table 1: External Sector Indicators

	$ export (goods + services) growth (%)	Export (goods)/GDP (%)	Current account/GDP (%)	Net FDI inflows (billion US $)	Foreign exchange reserves (billion US $)
2000-01	21.1	9.9	- 0.6	4.0	42.3
2001-02	- 1.6	9.4	0.7	6.1	54.1
2002-03	20.3	10.6	1.3	5.0	75.4
2003-04	23.3	11.1	2.3	4.3	113.0
2004-05	28.5	12.2	- 0.4	6.0	141.5
2005-06	23.4	13.0	- 1.2	8.9	151.6
2006-07	21.8	14.0	- 1.1	22.0	199.2

This statement of "successes" now has to be qualified by what has happened since September 2008. Since 2003-04, India's growth trajectory has been on an average trend of around 8.5%. This can in some sense be regarded as base-line growth. Clearly, until the global economy recovers, that can't be the new base-line. There is now consensus that growth will recover in the second half of 2009-10 and some signs are evident. However, since 1991, and even more since 2003-04, Indian growth has had three drivers – consumption, investment and exports. With an export/GDP ratio of 14% for goods and 21% for services, India cannot be de-coupled, though it has been less affected than China. The recovery therefore occurs in a global environment that is somewhat malign, not benign, and is contingent on endogenous sources. Nor should one forget that the global trade liberalization agenda is in limbo. Not only is the Doha Work Programme still stuck, though there are some signs of the impasse having been broken, there are increasing signs of protectionism.[18] Thus, two issues arise. First, what are the sectoral cum geographical implications of the slowdown in growth from 8.5% to 6.5%? Second, what policy options exist to cushion adverse effects and ensure faster recovery?

In discussing the employment implications, it is necessary to distinguish between losses in existing jobs and the non-creation of jobs that would otherwise have been created. Most media reports are about losses in existing jobs. But outside the external sector, there is little robust empirical evidence to substantiate this. Anecdotal reports about job losses in IT, ITES and financial services are quantitatively not that significant. There are no firm estimates of employment generation in the export sector, meaning in this context, exports of goods. There are rough estimates from Commerce Ministry of direct employment of 6.5 million in exports, with perhaps 15 million if indirect employment is included. Based on a survey undertaken by Labour Ministry and Commerce Ministry together, there have been government figures that around 1 million jobs may have been lost, especially in sectors like gems and jewellery, garments, leather and handicrafts. There is an independent FIEO

[18] Elisa Gamberoni and Richard Newfarmer, "Trade protection: Incipient but worrisome trends," 4th March 2009, http://voxeu.org/index.php?q=node/3183 document how several G-20 countries have introduced protectionist measures. The contrast in the language of the Washington and London communiqués of G-20 also shows that protectionism has come to be accepted as fait accompli. Some agricultural protectionism of course pre-dates the financial crisis and can be ascribed to the food crisis.

(Federation of Indian Export Organizations) survey, suggesting job losses of 10 million. Given what is known about employment in exports, this is probably widely off the mark. 1 million seems like a more realistic figure, at best touching 2 million. Export growth is not evenly spread out throughout the country. It tends to be concentrated in clusters. Among some major clusters are Surat (diamonds), Panipat (blankets), Tirupur (hosiery), Agra (leather), Ludhiana (woolen garments), Jaipur (hand-printed textiles), Pune (food processing), Ahmedabad (pharmaceuticals), Ambur (leather) and Bangalore (machine tools) and there are reports about these having been adversely affected, particularly in Surat, Tirupur and Ludhiana. Almost 70% of India's exports are manufacturing. Therefore, when one is talking about job losses in exports, this means job losses in manufacturing, especially job losses for those who are informally employed. There is informal employment not only in the unorganized sector, but also in the organized sector, with wage workers recruited through informal networks, such as through contractors, and without formal contracts.[19] When there are job cuts, it is these informal jobs that are slashed first. This leads to reverse migration from urban to rural areas and raises questions about the rural sector's capacity to absorb such returning migrants. There has also been reverse migration from abroad, particularly from the Middle East and back to Kerala.[20] An earlier ILO document, flagged such job loss concerns.[21] A subsequent ILO document mentioned a job loss figure of 20 million for China. Though no specific figures were given for India, this mentioned external migration (particularly pronounced in Kerala) and stated, "Workers in sectors with high exposure to the global market such as civil aviation, textiles, leather, gems, and jewellery, which employ millions of women workers, have already faced job cuts."[22] Let us now turn to jobs that would otherwise have been created, but will now not be created because of the growth slowdown. The last firm employment elasticities available are those that were worked out by C. Rangarajan and his colleagues when he was the Chairman of the Prime Minister's Economic Advisory Council. These used NSS (National Sample Survey) data for the period 1999-2000 to 2004-05.[23] The derived employment elasticities were 0.48 for total employment. In an aggregated and back-of-the-envelope kind of sense, lowering of growth from 8.5% to 6.5% means a counter-factual job loss of around 5 million. The rural sector, particularly in rice and wheat-growing irrigated areas, has been insulated and has offered a cushion to the growth slowdown. This is not very different from what happened in East Asia after the financial crisis of 1997-98, with rural and less integrated sectors suffering relatively less.[24] The counter-factual job loss of 5 million has primarily been in manufacturing, construction, trade, hotels and restaurants and transport, storage and communications. Although manufacturing is more visible, the elasticities are much higher for construction.[25] On the last point of policy responses to counter the slowdown,

[19] See the discussion in, *Report on Conditions of Work and Promotion of Livelihoods in the Unorganized Sector*, National Commission for Enterprises in the Unorganized Sector, Government of India, August 2007.

[20] The reverse flow of skilled and professional H1-B migrants isn't that significant quantitatively, notwithstanding a stricter visa regime and the Grassley-Sanders amendment.

[21] *Global Employment Trends*, ILO, January 2009, http://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/documents/publication/wcms_101461.pdf.

[22] *Responding to the Economic Crisis –Coherent Policies for Growth, Employment and Decent Work in Asia and Pacific, The fallout in Asia: Assessing labour market impacts and national policy responses to the global financial crisis*, ILO, February 2009, http://www.ilo.org/wcmsp5/groups/public/---asia/---ro-bangkok/documents/meetingdocument/wcms_101730.pdf

[23] "Revisiting Employment and Growth," C. Rangarjana, Padma Iyer Kaul and Seema, *Money and Finance*, September 2007, http://eac.gov.in/aboutus/chspe/art_revisit.pdf

[24] See the discussion in See, Martin Ravallion, "Bailing out the World's Poorest," *Policy Research Working Paper*, No. 4763, World Bank, October 2008, http://www.wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/2008/10/29/000158349_20081029084618/Rendered/PDF/WPS4763.pdf

[25] Indeed, construction shares much of the characteristics of services and it is a moot point whether it should be included in services when classifying national accounts.

conceptually, policy responses can be of three types – structural reforms, fiscal policy and monetary policy. However, we will leave that as it is too much outside the purview of the present paper. But while on the slowdown, an export (goods) target of 200 billion US dollars had been set for 2008-09. Actual exports were 168.7 billion.

Section 2: The South Asian Liberalization and Growth Perspective

Not only have growth rates picked up in India, they have picked up throughout the South Asia region. Since April 2007, when Afghanistan became a member, SAARC (South Asian Association for Regional Cooperation) has had eight members. In December 1985, the seven founder members were Bangladesh, Bhutan, India, Nepal, Maldives, Pakistan and Sri Lanka. Definitions of South Asia often vary, such as on inclusion of Iran and Myanmar, especially if a Greater Middle East region is conceived, or if definitions are based on geography (countries that are on the Indian plate) or history (the British colonial legacy). However, for all practical purposes, SAARC can be used as a synonym for South Asia. SAARC is a poor region. Table 2 shows some summary indicators.[26] Several comments are in order about this table. First, data are not available for countries like Afghanistan, Bhutan and Maldives. Second, computation of head count ratios on poverty requires household surveys. As the table shows, surveys are often dated.[27] Surveys can be based on income or on expenditure. Since income data are perceived to be somewhat more unreliable, many countries in the world collect data on expenditure and not on income. This is invariably true of all the countries in the SAARC region that collect data through household surveys. They are all based on expenditure. And they all suffer from the mismatch or under-reporting problem, in the sense that the aggregate of consumption expenditure obtained through household surveys falls short of the aggregate of consumption expenditure obtained through national accounts and down the years, the gap has increased rather than decreased. This raises a conceptual concern. How can one hope to correlate the trickle-down benefits of growth on poverty reduction if the growth is captured in the national accounts data, but not in the survey data? Third, since data are based on consumption expenditure, any measure of inequality in personal distributions will also be based on expenditure. Therefore, it will tend to under-estimate income inequality. Fourth, while one doesn't expect poverty figures through national and international ($1 a day) poverty lines to exactly tally, the orders of magnitude shouldn't be remarkably different. After all, the World Bank doesn't conduct its own household surveys. All that varies is the computation of the poverty line, with a PPP (purchasing power parity) conversion undertaken by international organizations like the IMF or the World Bank. Given this, question marks should legitimately be raised about the numbers for Pakistan and Sri Lanka. Fifth, as the table shows, poverty is fundamentally a rural phenomenon throughout the SAARC region, with the trend less marked for India. And one should also flag the point that urbanization levels tend to be low in South Asia, even by developing country standards.

[26] These are from *World Development Indicators 2005*, http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPOVERTY/0,,contentMDK:20205999~isCURL:Y~menuPK:497971~pagePK:148956~piPK:216618~theSitePK:336992,00.html. Consequently, they pre-date the revision of the international poverty line by the World Bank to $ 1.25 a day.

[27] There is a 2004-05 large sample survey for India, but that wasn't included in *World Development Indicators 2005.*

Table 2: Expenditure Poverty Ratios

Country & survey year	% rural below national poverty line	% urban below national poverty line	% total below national poverty line	% total below $ 1 per day
Bangladesh, 2000	53.0	36.6	49.8	36.0
India, 1999-2000	30.2	24.7	28.6	34.7
Nepal, 1995-96	44.0	23.0	42.0	39.1
Pakistan, 1998-99	35.9	24.2	32.6	13.4
Sri Lanka, 1995-96	27.0	15.0	25.0	7.6 (1999-2000)

One should not mix up issues. It is one thing to argue that expenditure poverty ratios are still too high in the SAARC region and need to be reduced much faster. Extrapolating the same argument, one can legitimately make the point that the absolute numbers of the poor are still very high. However, the proposition that poverty ratios have not dropped is not tenable, baring the case of Pakistan. The stagnation of the decline is pronounced in Pakistan and to a lesser extent, in Sri Lanka. It is important to make this point because the World Bank's recent increase in the poverty line to 1.25$ a day is often misunderstood. This increase in the international poverty line is due to better estimates of PPP (purchasing power parity) dollars becoming available, because better quality price data are now available.[28] "The poverty rate has fallen in South Asia from 60% to 40% between 1981 and 2005. But this has not been enough to bring down the number of poor."[29] In South Asia, the drop in the percentage of the population below $ 1 a day has been from 42.7% in 1981 to 23.7% in 2005, below $ 1.25 a day from 60.3% in 1981 to 40.4% in 2005 and below $ 2.00 a day from 87.0% in 1981 to 74.0% in 2005. That is 350.3 million people below $ 1 a day in 2005, 595.8 million people below $ 1.25 a day in 2005 and 1091.9 million people below $ 2.00 a day in 2005.

While the impact of growth on poverty reduction is a function of the composition of growth and its distribution, one would expect the much-maligned trickle-down to reduce poverty. On the former, given what was said earlier about concentration of poverty in rural areas of South Asia, the growth of the agricultural/rural sector becomes critical, since creation of off-farm employment opportunities and commercial and diversification of classic agriculture hasn't occurred. On the latter, the distribution of growth has a spatial cum geographical dimension, as well as one of personal distributions. However, on both, regardless of which measure of inequality is used and subject to the caveat that all data are on expenditures rather than income, there is no evidence of distributions having worsened markedly in the process of growth. With the exception of Sri Lanka and to a lesser extent, India, inequality levels are relatively low. Perhaps one should add that survey data are dated. And once data from later rounds of surveys come in, the poverty ratios should drop even more. It is worth mentioning that income and expenditure distributions are typically

[28] "The developing world is poorer than we thought, but no less successful in the fight against poverty", Shaohua Chen and Martin Ravallion, *Policy Research Working Paper*, World Bank, http://econ.worldbank.org/docsearch.
[29] *Ibid.*

log normal. Hence, once the thick part of the distribution passes above the poverty line, however defined, sharp drops in poverty ratios are possible. This is not to suggest complacency about the level of expenditure poverty in the SAARC region, since the absolute levels involved are still fairly high. But the substantial reductions also need to be recognized.

This has largely been an outcome of liberalization within the SAARC region. All the South Asian economies have introduced reforms in the 1980s. Bangladesh introduced trade policy reforms in 1985 and there were more reforms in 1987, followed by broader reforms in the 1990s. Bhutan has special circumstances, but reforms can be traced back to the 1960s. The Indian reforms have already been mentioned, beginning in the second half of the 1970s and attaining greater momentum since 1991. The circumstances of Maldives are also special. However, economic reforms were introduced in 1989. Nepal witnessed several reforms in the 1990s, as did Pakistan. Sri Lanka was the first economy in the SAARC region to introduce reforms, beginning in the 1970s. Savings/investment rates have increased, efficiency of capital usage has gone up.[30] There have been productivity gains and even some impact of the demographic dividend. The trickle-down effects of growth on poverty reduction are also evident, when there is something to trickle down. Obviously, the individual experience varies from country to country, but as a generalization, the statement is probably correct. As a logical corollary, there have been two side-effects, even if they are not always very tangible. First, barring the agriculture problem, protectionist sentiments are much less now. In general, beneficiaries of liberalization are consumers and losers can be inefficient producers. Consumer voices are heard a little bit more often and inefficient producer voices a little less. Second, there is a desire to jump onto the India Shining bandwagon for its resultant positive externalities. That too makes a SAARC process easier to accept.[31]

Some summary indicators of macroeconomic performance are shown in Table 3.[32] To restate the obvious, the region is a poor one, with all economies barring India, Pakistan and Sri Lanka classified as LDC. Afghanistan and Maldives also have some special characteristics, true to a lesser extent, also of Bhutan. Before the recent financial crisis, all the eight economies displayed better macroeconomic performance, with a greater degree of openness to the external world. But one should also note that all these countries have a large percentage of the population employed in agriculture (the Maldives is an exception), though agriculture's share in GDP isn't invariably high. Indeed, the share of industry (and manufacturing) in GDP tends to be low (with the exception of Bhutan) and the share of services significantly higher. With an annual remittance inflow of 6.6 billion US dollars, remittances account for 436.9% of ODA receipts, 9.5% of GDP and 10.1% of FDI inflows in Bangladesh.[33] They are 35.3 billion US dollars for India, 2716.2% of ODA receipts, 3.1% of GDP and 1.5% of FDI inflows. They are 1.7 billion US dollars for Nepal, 289.8% of ODA receipts, 15.5% of GDP and 302.1% of FDI inflows. They are 6 billion US dollars for Pakistan, 569.1% of ODA receipts, 4.2% of GDP and 0.4% of FDI inflows. Finally, they are 2.5 billion US dollars for Sri Lanka, 429.1% of ODA receipts, 8.1% of GDP and 4.2% of FDI inflows.

[30] Measured, for instance, by the incremental capital/output ratio.

[31] In passing, the link between reforms and corruption is not always clear. In the long run, reforms should reduce discretion and decrease corruption of certain kinds, apart from eliminating corruption linked to shortage economies. However, in the short run, some reforms may also increase discretionary opportunities and thereby increase corruption.

[32] World Development Indicators database.

[33] These figures are from *Human Development Report 2009, Overcoming Barriers: Human mobility and development*, UNDP and Oxford University Press, 2009.

Table 3: Summary Indicators of Macroeconomic Performance, SAARC, 2008

	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Atlas per capita income ($)	-	520	1990	1070	3630	400	980	1780
PPP per capita income ($)	-	1440	4880	2960	5280	1120	2700	4460
GDP growth (%)	16.2 (2007)	6.2	13.8	7.1	5.8	5.3	6.0	6.0
Industry value added (% of GDP)	25 (2007)	29	46	29	-	17	27	29
Services value added (% of GDP)	38 (2007)	52	35	53	-	50	53	57
Exports (% of GDP)	17 (2007)	19	67	24	-	12	12	25
Imports (% of GDP)	57 (2007)	28	79	30	-	33	22	38
Capital formation (% of GDP)	31 (2007)	24	47	39	54 (2005)	32	22	27
Net FDI inflows (billion $)	0.29 (2007)	0.65 (2007)	0.08 (2007)	22.95 (2007)	0.02 (2007)	0.006 (2007)	5.3 (2007)	0.6 (2007)
ODA (billion $)	4.0 (2007)	1.5	0.09 (2007)	1.3	0.04 (2007)	0.6 (2007)	2.2 (2007)	0.6 (2007)

The summary indicators of Table 3 are a bit like the half-full part of the glass. However, there is the half-empty part too and these have to do with what can broadly be called governance indicators and surveys. It is not quite the case that there aren't problems with these surveys.[34] The point is not to denigrate the use of governance surveys. After all,

[34] See, Besancon, M, "Good Governance Rankings: The Art of Measurement", *World Peace Foundation Report, No. 36*, Cambridge, MA, 2003; Sudders, M. and Nahem, J, *Governance Indicators: A Users' Guide*, UNDP, Oslo, 2004; Landman, T. and Häusermann, J, "Map Making and Analysis of the Main International Initiatives on

one is trying to capture something that is difficult to measure. However, most governance surveys tend to gloss over these problems and suggest robustness in governance estimation that simply does not exist. Having said this, the most commonly cited governance surveys are (1) Transparency International's[35] Corruption Perceptions Index; (2) The World Bank Institute's Governance Matters set of indicators[36], with governance measured under six aggregate heads or clusters – voice and accountability, political stability and absence of violence, government effectiveness, regulatory quality, rule of law and corruption; (3) World Economic Forum's Growth Competitiveness Index[37], based on three components of economic growth – a technology index, a public institutions index and a macroeconomic environment index; (4) Heritage Foundation and *Wall Street Journal*'s Index of Economic Freedom[38], based on ten broad factors of economic freedom – trade policy, fiscal burden of government, government intervention in the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation and informal market activity; (5) Fraser Institute's Economic Freedom of the World[39], based on five heads of size of government, legal structure and security of property rights, access to sound money, freedom to trade internationally and regulation of credit, labour and business; and (6) The World Bank's Doing Business Indicators[40], based on starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business. This is by no means a comprehensive list of all governance surveys, but these are certainly the more important ones. Table 4 shows how South Asia scores on these and the results are hardly flattering. There is subjectivity in each of these surveys, on responses to questionnaires, attaching weights, converting ordinal ranks into cardinal scores and methods of aggregation. Consequently, not too much weight need be attached to any particular survey. However, taken together, the surveys do show robustness and underline institutional problems throughout the SAARC region. Most of these have to do with lack of domestic and internal reforms, as opposed to external sector reforms. One should not form the impression that all East Asian countries perform better than SAARC countries on such governance indicators. There are laggards within East Asia too. However, the better-performing East Asian economies do out-perform the SAARC region.

Developing Indicators on Democracy and Good Governance", University of Essex, Human Rights Centre, *Report for the Statistical Office of the Commission of the European Communities (EUROSTAT)*, 2002; .Kaufmann, D., Kraay, A. and Zoido-Lobatón, P, "Governance Matters III: Governance Indicators for 1996-2002", *Draft Paper*, World Bank, Washington, D.C., 2003; Hyman, G. and Silver, R, *Handbook of Democracy and Governance Program Indicators*, USAID, Washington, D.C., 1998; Kaufmann, D., Kraay, A. and Zoido-Lobatón, P, "Governance Matters: From Measurement to Action", *Finance and Development*, 37(2), 2000; and Kapoor, I, "Donor Participatory Governance Evaluation: Initial Trends, Implications, Opportunities, Constraints", *Journal of International Development*, 16 (2), 157-170, 2004, for excellent discussions of the methodological problems.

[35] www.transparency.org/surveys.

[36] www.worldbank.org/wbi/governance.

[37] www.weforum.org

[38] www.heritage.org/research.

[39] www.freetheworld.com

[40] http://www.doingbusiness.org

Table 4: Governance Indicators for SAARC

	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Transparency International, 2009 rank out of 180 countries	179	139	49	84	130	143	139	97
World Bank Institute, 2008, governance score on government effectiveness	- 1.31	- 0.77	+ 0.11	- 0.03	- 0.35	- 0.75	- 0.73	- 0.29
World Bank Institute, 2008, governance score on regulatory quality	- 1.58	- 0.82	- 0.86	- 0.21	- 0.42	- 0.66	- 0.47	- 0.28
World Bank Institute, 2008, governance score on rule of law	- 2.01	- 0.70	+ 0.37	+ 0.12	- 0.24	- 0.76	- 0.92	- 0.01
World Bank Institute, 2008, governance score on control of corruption	- 1.64	- 1.10	+ 0.72	- 0.37	- 0.60	- 0.68	- 0.77	- 0.15
World Economic Forum's 2009-10 GCI score	-	3.55	-	4.30	-	3.34	3.58	4.01
Index of Economic Freedom, 2009 score	-	47.5	57.7	54.4	51.3	53.2	57.0	56.0
Fraser Institute's 2009 summary score	-	5.77	-	6.50	-	5.18	5.84	5.93
Doing Business rank, 2010, out of 183 countries	160	119	126	133	87	123	85	105

Section 3: The manufacturing versus service sector story

While this section is India-specific, the points made also often apply to Bangladesh, Nepal, Pakistan and Sri Lanka. The etymology of the word "manufacture" isn't certain. But it seems to have a link with the Latin *manu factum*, meaning "made by hand". Irrespective of ingredients of technology, capital (plant and machinery), entrepreneurship, and perhaps

even land, entering as inputs or factors into production processes, labour remains a core input. And there is no denying that India possesses, or should possess, a comparative advantage in labour. As with every other developing country, that has always been the case. Labour is relatively more abundant than capital. In a completely integrated and globalized world, national boundaries should make no difference. But that ideal never happens. Even if cross-border movements of technology and capital are relatively free, there will be restrictions on cross-border movements of labour. Integration of labour markets will only happen in niches, in selected segments. Therefore, India should be in a position to exploit its cost advantage in labour, and in natural resources, to push manufacturing growth. Nor should one forget India's strengths in science and technology and in education. These reinforce the labour cost advantage.

To this traditional labour cost advantage has been added what is called the demographic dividend, a point also mentioned in an earlier section. With aging populations in developed countries, and even in countries like Russia and China, there has been talk of India's demographic dividend.[41] That the demographic dividend argument works, is known. For East Asia, several studies suggest that between 25 to 40% of the East Asian miracle was due to the demographic dividend.[42] Other than East Asia, it has worked in Japan in the 1950s, China in the 1980s and Ireland in the 1980s and the 1990s. Several factors explain the demographic dividend.[43] First, there is the obvious increase in working-age populations, with a reduction in dependency ratios, and the direct impact of a larger quantity of labour input. To take but one dramatic number, between 2001 and 2026, India's total population is estimated to increase by 371 million and 83% of the increase will occur in the age-group of 15-59 years.[44] Second, the quality of the labour input can increase and this is reflected in what economists call total factor productivity (TFP) growth, measured after netting out the contribution of increased labour and capital inputs.[45] Third, when dependency ratios decline, savings rates increase, leading to increases in investment rates and higher rates of GDP growth. Fourth, if the decline in dependency ratios is at the lower end of the age spectrum as a result of fertility declines, female work participation rates increase.

India's Eleventh Five Year Plan (2007-12) projects an annual real rate of GDP growth of 9%, an increase from the 7.74% registered during the Tenth Plan (2002-07).[46] The target rate of growth for industry is 10-11%, again an increase from 9.17% registered during the Tenth Plan. A longish quote from the Plan document is illustrative of government intentions. "Industrial performance in the Tenth Plan period improved to a respectable

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[41] "India: On the Growth Turnpike," Vijay Kelkar, 2004 K.R. Narayanan Oration, Australian National University, reprinted in Raghbendra Jha edited, *The First Ten K.R. Narayanan Orations*, ANU Press, 2006; *Can India grow without Bharata?*, Shankar Acharya, Academic Foundation, 2007; "The Indina Model," Gurcharan Das, *Foreign Affairs*, July/August 2006; *India rising; a medium term perspective*, Deutsche Bank Research, May 2005; "Growing Old the Hard Way: China, Russia, India," Nicholas Eberstadt, *Policy Review*, Hoover Institution, April/May 2006; and "Dreaming with BRICs: The Path to 2050," Dominic Wilson and Roopa Purushothaman, *Global Economics Paper No. 99*, Goldman Sachs, October 2003, are some instances.

[42] See, David E. Bloom, David Canning and Jaypee Sevilla, "Economic Growth and the Demographic Transition," *NBER Working Paper 8685*, December 2001.

[43] The empirical and theoretical literature is reviewed in *World Economic Outlook, The Global Demographic Transition*, IMF, September 2004.

[44] *Population Projections for India and States 2001-2026, Report of the Technical Group on Population Projections Constituted by the National Commission on Population*, Office of the Registrar General and Census Commissioner, May 2006.

[45] Some skepticism of TFP estimation is warranted. However, one study that contrasted India and China in two sub-periods, 1989-1995 and 1995-2003, is worth mentioning, since it found that the labour contribution to India's growth was driven more by quantity than quality. See, Dale Jorgenson and Vu Khunog, "Information Technology and the World Economy," *Scandinavian Journal of Economics*, Vol. 107, No. 4, 2005.

[46] *Eleventh Five Year Plan, 2007-2012, Vol.I, Inclusive Growth*, Planning Commission, Government of India and Oxford University Press, 2008.

9.2% from the very low growth rate of 4.3% in the Ninth Plan. However, industrial performance needs to be improved further if high quality employment in the non-agricultural sector is to be generated. Within industry, the manufacturing sector, accounting for 77% of industrial output has shown significant growth acceleration in the last two years. This revival of dynamism in industry has to be sustained to reverse the unacceptable decline in the share of manufacturing in GDP that has happened since 1991. This will also help generate more employment opportunities for the burgeoning workforce. The Eleventh Plan aims at double digit growth both in manufacturing and in industry. At the same time, it will be critical to improve the performance of the core sector (steel, coal, cement, oil, fertilizers and refined petroleum) to ensure that their supply response is adequate to sustain double digit manufacturing and industrial growth. Accelerated growth in industry will help to provide faster growth in organized sector employment, which is typically of a higher quality."

Given the quote, this is right place to mention the organized versus unorganized sector dichotomy. There are indeed three different definitions of organized/unorganized, although they do overlap. First, there is the labour law kind of definition, the Factories Act of 1948 being the obvious example, although this only applies to "factories". Registration is required if a factory employs 20 or more people and doesn't use power or if it employs 10 or more people and uses power. Registration is equated with organized and everything else is unorganized. Second, there is a definition of small-scale industry (SSI), in terms of threshold levels of investment in plant and machinery. SSI is often equated with unorganized manufacturing. Third, there is a threshold level of turnover below which, excise doesn't have to be paid. Excise exemption constitutes yet another definition of unorganized. However, whichever definition of unorganized/organized one uses, the organized sector accounts for less than 8% of the work force. The National Commission for Enterprises in the Unorganized Sector (NCEUS) also pointed out that there can be workers apparently employed in the organized/formal sector, who are on informal contracts. They too are therefore unorganized/informal. NSSO (National Sample Survey Organization) large-sample data are available at five-yearly intervals and the last such NSSO round is still that of 2004-05. Using 2004-05 data, NCEUS estimated total employment of 457.5 million and informal/unorganized sector employment of 394.9 million, that is, 86%.[47] This overall figure masks inter-State variations and in a State like Bihar, the unorganized sector share is as high as 96.2%. Conversely, in a State like Goa, it is as low as 62.2%. Of the 395 million who are employed in the unorganized/informal sector, 253 million work in agriculture and 142 million are employed in the non-agricultural sector. But of these 142 million, 89 million report themselves as self-employed. With reforms, the dichotomy between the organized and unorganized sectors should break down. The organized sector is under the purview of labour laws, which are certainly rigid. Liberalization will involve making labour market provisions in the organized sector more flexible. However, it should also be noted that the unorganized sector is completely outside the purview of most labour laws, and this includes social security. Liberalization will also involve extending protection to labour in the unorganized sector. As development occurs and segmentation breaks down, the share of organized/formal components in the labour force should increase and the share of self-employment should decline, with a parallel decline in the contribution of agriculture to employment. However, that is in the future and these are the numbers as of today, or more accurately, as of 2004-05. In the context of inter-State differences, an additional point may be worth mentioning. Most of the demographic dividend, in terms of new entrants into the labour force, is going to occur in central parts of India, leading eastwards. In an era of industrial licensing,

[47] *Report on Conditions of Work and Promotion of Livelihoods in the Unorganized Sector*, National Commission for Enterprises in the Unorganized Sector (NCEUS), August 2007.

manufacturing capacities could be set up in geographical areas where labour forces existed. But industrial licensing is not only impossible now, it is also undesirable. Nor will employment growth primarily happen through the public sector, and it must not be forgotten that many sick public sector units (PSUs) are precisely in these geographical regions and they will eventually be closed down.

Comments are also necessary about the definition of manufacturing and data collection systems. The basic classification of all economic activities is the UN system's International Standard Industrial Classification (ISIC).[48] At the 2-digit level, these are also the classifications followed by the CSO (Central Statistical Organization). Section D constitutes manufacturing in the industrial classification and the 2-digit codes and descriptions are common to both ISIC and CSO. There are some problems in deciding what should constitute manufacturing and what should not. But there is no need to get into those problems. Beyond such problems, there are serious issues with CSO's data collection exercises. "The entire manufacturing activities are classified into two broad sectors, viz., manufacturing - 'registered' and 'unregistered'. The registered manufacturing sector covers all factories covered under sections 2m (i) and 2m (ii) of the Indian Factories Act (IFA), 1948 which respectively refers to the factories employing 10 or more workers and using power or those employing 20 or more workers but not using power on any day of the preceding 12 months and bidi and cigar establishments registered under Bidi and Cigar Workers (Condition of Employment) Act, 1966 and employing 10 or more workers using power or 20 or more workers and not using power."[49] Indeed, factories where a manufacturing process is not carried on are excluded. "The 'manufacturing process' is defined as any process for (i) making, altering, repairing, finishing, packing, oiling, washing, cleaning, breaking up, demolishing or otherwise treating or adapting any article or substance with a view to its use, sale, transport, delivery or disposal; (ii) pumping oil, water, sewage or any substance; (iii) generating, transforming or transmitting power; (iv) composing types for printing, printing by letter press, lithography, photogravure or other similar process or book binding; (v) constructing, reconstructing, repairing, refitting, finishing or breaking up of ships or vessels; (vi) preserving or storing any article in cold storage. Factories registered under IFA but not engaged in manufacturing activities are excluded." There is thus a dichotomy between registered manufacturing and unregistered manufacturing. For registered manufacturing, data are collected annually through the Annual Survey of Industries (ASI). This is part survey (sample) and part census. Unregistered manufacturing, which also includes own account enterprises, is covered much less frequently, typically, once every five years. In 2001, there was a fairly serious critique of the entire Indian statistical system.[50] Although the criticisms were greater for other sectors of the economy, manufacturing data were also criticized – in all the four components of ASI, unregistered manufacturing, small-scale industries (SSI) and the index of industrial production (IIP). For instance, other than time lags and sampling and non-sampling errors, the ASI includes units that shouldn't be included (they have closed down) and excludes units that should be included. Different databases of unregistered (census or survey) manufacturing vary widely, perhaps understandable, because differing concepts and definitions are used. This is compounded by lack of adequate data on SSI and unorganized traditional industries (village and small industries). The discrepancies are remarkable. Finally, other than the problem that the index of industrial production (IIP) represents only 80% of manufacturing, there are problems associated with low response rates, small samples, unsatisfactory weights and non-representation of the unorganized

[48] Revision 3.1. This is not identical with the North American Industrial Classification System (NAICS), although difference surface at levels of disaggregation far beyond the 2-digit level.
[49] *NAS – Sources and Methods*, CSO, 1989.
[50] *Report of the National Statistical Commission*, August 2001.

sector. As a generalization, manufacturing data are therefore somewhat satisfactory for registered manufacturing and extremely unsatisfactory for everything else. There are thus problems in national accounts. Unregistered manufacturing often tends to be clubbed with services, blowing up the service sector contribution and reducing that of manufacturing. One should not drive the point too hard though. The fact remains that the manufacturing share in GDP is fairly low.

Industry's share in GDP has been around 26%, with a manufacturing contribution of around 15%, the non-manufacturing component primarily consisting of mining and quarrying. The shares are of that order in Bangladesh, Pakistan and Sri Lanka too. While the shares vary across East Asian countries and China at 45% is a bit of an outlier, between 25-30% is a rough benchmark for East Asia and the South Asian contribution of manufacturing falls far short. In India, agriculture's share in GDP has been declining and is now around 18%, with services contributing 56%. Effectively, services picked up what agriculture has dropped. What does it mean to say that manufacturing's share of GDP should be 30%? At one level, one is arguing that historically, manufacturing could have done better and compared to other countries in East Asia, there is no reason why the share today should not have been 30%, as compared to 15%. This is a valid point to make. But at another level, one is arguing that there should be a game plan to take manufacturing's share to 30%. This is more questionable, more so if it is articulated in terms of manufacturing's share, as opposed to industry's share. Manufacturing's share is a function not only of manufacturing growth, but also of growths in other sectors. For instance, there is no reason why service sector growth should slow down. And non-manufacturing industry will continue to account for at least 10% of GDP. While agriculture's share in GDP ought to progressively decline, no reasonable projection will assume an agricultural contribution of less than 10% in the next twenty years. That leaves a manufacturing contribution to GDP of 20% and no more, with services contributing around 60%. Anything more than a 25% contribution of manufacturing to GDP is extremely implausible.

Nevertheless, what are the constraints to increasing manufacturing's share to around 20% of GDP? The constraints themselves suggest the solutions. Some of the constraints are generic in the sense that they cut across all manufacturing sectors. The others are more specific and pertain to specific sectors. Let us list out the generic problems, some of which are implicit in the governance indicators of Table 4. These have been discussed several times.[51] A National Manufacturing Competitiveness Council (NMCC) was set up in 2005. In 2006, this produced a National Strategy for Manufacturing.[52] Barring infrastructure, which is specifically addressed in Section 4, these generic problems are the following.

Taxation – This has both a direct and an indirect tax angle and the directions for reform are known, involving standardization, harmonization and removal of exemptions, with reduction in compliance costs.[53] While direct corporate tax rates have been reduced, there are still several exemptions, leading to distortions in resource allocation and varying the incidence across sectors. Without elimination of discretionary exemptions, it is also

[51] Arvind Panagariya, *India, The Emerging Giant*, Oxford University Press, 2008, *Eleventh Five Year Plan, 2007-2012, Vol. III,* Planning Commission, Government of India, Oxford University Press, 2008 and *Made in India – the next big manufacturing export story*, CII-McKinsey, October 2004 are examples.

[52] *The National Strategy for Manufacturing*, 2006, http://nmcc.nic.in/pdf/strategy_paper_0306.pdf

[53] *Implementation of the Fiscal Responsibility and Budget Management Act, 2003, Report of the Task Force*, July 2004, summarizes both direct and indirect tax reform intentions succinctly. On both direct and indirect taxes, there should be reforms in 2010-11.

difficult to reduce collection, enforcement and compliance costs. The broad shape of indirect tax reform is also clear. There should be a combined goods and service tax (GST), with service sector taxation integrated into the VAT framework instead of being a tax on turnover. This will be accompanied by a withdrawal of all other taxes like central excise, central sales tax, octroi, State-level sales tax, entry tax, stamp duties, transportation taxes and so on. The problems with the earlier indirect tax structure are known. First, the tax base is fragmented between Centre and States. Second, services are not taxed properly and not integrated into a VAT (value added tax) framework. Third, there are cascading effects and multi-point and multiple (tax on tax) taxation exist. Fourth, discretion and exemption lead to distortions in resource allocation and tax revenue is disproportionately dependent on a few items. Fifth, tax administration is also complicated and there is no harmonization of classification and valuation. Sixth, tax rates varied from one State to another, leading to tax arbitrage and rate wars among States. A VAT, with unification of State-level sales tax, was introduced between 2003 and 2006, with most States coming on board from April 2005. Uttar Pradesh was the last State to switch in January 2008. But this was never a complete VAT. It was no more than unification of State-level sales tax and there were problems there too, since the rates varied from State to State. It is now proposed that a unified goods and services tax (GST) will be introduced from April 2010. But there are uncertainties about the time-line and there are also uncertainties about whether GST will continue to have inter-State variations and about whether local body taxes will be eliminated. "At present the incidence of CENVAT and State VAT together is about 23%. In addition, States and local levels of government levy such taxes as octroi or entry tax, etc. The overall rate of indirect taxes compare unfavourably with those prevailing in Association of South-East Nations countries, which are closer to 10%-12%.[54] However, such declines in indirect tax rates are only possible if the share of direct taxes increases and all exemptions are terminated – product-specific exemptions, SSI (small-scale industry) exemptions and location-based exemptions. There are two additional problems with the indirect tax structure. First, across raw materials, intermediates and finished goods, there is often an inverted duty structure and regional trading agreements (RTAs) have also contributed to this. Second, there is a conceptual difference between export incentives and export subsidies. Export subsidies involve differential treatment to exports as compared to sales in the domestic market and are in general WTO-incompatible, although there are some exemptions for India. Export incentives are WTO-compatible, as they involve reimbursements (DEPB and duty drawback) or waivers (advance licences) for duties paid in exported products. But problems arise because the indirect tax structure is non-transparent and legitimate export incentives become labeled as unwarranted export incentives. For similar reasons, it also becomes difficult to impose legitimate countervailing duties on imports.

Labour laws – Labour law reform is usually equated with Chapter V-B of the Industrial Disputes Act (IDA), but the issues are more complicated. Subject to the caveat that labour is on the concurrent list of the Constitution, there are 45 Central Acts and 16 associated rules that deal directly with labour. There are others that indirectly deal with labour, like *the Boilers Act (1923), the Collection of Statistics Act (1953), the Dangerous Machines (Regulations) Act (1983)* and the *Emigration Act (1983)*. There is thus an issue of unification and harmonization, the lack of which contributes to the inspector raj. Over a period of time, concepts and definitions have changed. So has the case law, contributing to further confusion. After unification and harmonization, one should mention reductions in State intervention, in areas other than industrial relations. *The Factories Act* is a good example of unnecessary government stipulations, sometimes through resultant rules. *The Shops and Establishments Act* of 1954 is yet another example. It is no one's case that welfare provisions should not exist. But are welfare provisions enacted in 1948 or 1954 still

[54] Planning Commission, Vol. III, *ibid.* CENVAT is the Central value added tax.

relevant? Assuming that they are, is the present government-mandated system with a regime of inspectors the best way to achieve the objective?[55] Each labour legislation has a separate inspector and visits of inspectors are not synchronized across all labour enactments. Barring *the Payment of Wages Act*, where a maximum period of three years is stipulated, no other labour statute prescribes a maximum period for which records and registers must be maintained. Compliance is thus impossible and visits of inspectors result in bribery and rent-seeking. This system is not distributionally neutral as it tends to hurt the small-scale sector much more than it hurts large-scale industry. That apart, returns under various labour laws are not standardized and inspectors insist on maintenance of manual records and registers. Finally, there is the matter of industrial relations. The three statutes that impinge on industrial relations are *the Contract Labour (Regulation and Abolition) Act, the Trade Unions Act* and *the Industrial Disputes Act. The Contract Labour (Regulation and Abolition) Act* was never mean to prohibit contract labour. Section 10 provided the appropriate Government the discretion of prohibiting contract labour in selected areas. In fact, in the title of the act, regulation comes before abolition. Contract labour allows flexibility and permits outsourcing. However, a few court judgements have affected this flexibility. Next one should mention *the Trade Unions Act* and its provisions of lead to multiplicity of trade unions. The multiplicity problem impinges on collective bargaining because an agreement with one union is not necessarily binding on others. Maharashtra and Gujarat are the only States where there are laws requiring recognition of trade unions by employers for purposes of collective bargaining. Finally, there is *the Industrial Disputes Act (IDA)* and the following is a list of sections where there are problems - Section 9-A, Section 11, Section 11-A, Section 17-B, Sections 22/23 and Chapter V-B/Sections 25-K, 25-L, 25-M, 25-N and 25-0. The argument about Chapter V-B of IDA is indeed a valid one. Labour markets become artificially rigid, employers adopt artificially high capital intensity and circumvent the legislation. An employer-employee relationship ought to be in the nature of a personal contract, with an optional provision of resorting to the government in case of exploitation. However, the provisions of *the Industrial Disputes Act* make recourse to the government and thus to Labour Commissioners, mandatory. Unless this rigidity in labour markets is removed, higher growth will not necessarily translate into greater employment. What is involved is not primarily an exit policy for labour. The statute makes it impossible for companies to exit. It is not surprising that organized sector Indian manufacturing should be capital intensive rather than labour intensive.[56]

Entry and exit problems and administrative law – Ostensibly, there are no licensing requirements any more. However, this needs to be qualified. For some sectors, licensing still exists – liquor, tobacco, aerospace and defence equipment, industrial explosives and hazardous chemicals. There are limited reservations for the public sector – atomic energy and railway transport. However, 114 items are still reserved for the small-scale industry (SSI) sector and large-scale investment in these is only permitted if 50% of the production is exported. While FDI caps don't exist in manufacturing[57], they do exist in several services, including retail. Nor do satisfactory exit procedures exist for the non-corporate sector. But both on entry and exit, the more important problem is about procedures, not about law, legislation or policy *per se*. This is the broad area of administrative law reform and if India

[55] An undated FICCI survey (*Inspector Raj and Administrative Reforms Required for Indian Manufacturing*) mentions an average of 37 annual inspections, with 67 inspections in some cases. In decreasing order of importance, these inspections concern environment, labour, sales tax, excise, provident fund, electricity, ESI and industrial safety and health.

[56] See, Kalpana Kocchar, Utsav Kumar, Raghuram Rajan, Arvind Subramanian and Ioannis Tokatlidis, "India's Pattern of Development: What Happened, What Follows," *Working Paper 12023*, National Bureau of Economic Research, 2006.

[57] There is a foreign equity cap in public sector enterprises that are in petroleum refining.

doesn't perform well on Doing Business-type indicators, that is because of these procedural problems, also important for labour law. Administrative law means the subordinate legislation in the form of rules, regulations, orders and instructions from ministries and government departments and these can be at State-level, as well as Central. Often, constraints to efficient decision-making come about through administrative law, rather than through statutory law and discretion, bribery and rent-seeking are fallouts. Unfortunately, administrative law is not readily available and this is especially true at State-level. Administrative law reforms are often interpreted as civil service reforms, although they should be much more than civil service reform. The broader agenda of administrative law reform involves two kinds of relationships that can overlap – dealings between the citizen and the government and dealings between an enterprise and the government. The latter can again be divided into three phases of an enterprise's existence - entry, functioning and exit. On the entrepreneurial side, countervailing pressure, highlighting constraints to efficient decision-making through discretionary subordinate legislation, have been highlighted in reports brought out by larger chambers of commerce and industry like FICCI, CII and ASSOCHAM.[58] But one should not form the impression that big business alone is the issue. Since transaction costs have economies of scale and scope, they have a distributional angle and hurt the small entrepreneur more. In 2000, the Prime Minister's Council on Trade and Industry also submitted a report on administrative and legal simplifications.[59] Understandably, this had an industry focus and listed the following as industry concerns. "Large number of clearances / permissions required; Complex regulation governing day to day functioning; Multiple agencies regulating operations functioning independently; Lack of co-ordination between various governing agencies; Frequent changes in policies / procedures / tariff structures; Unpredictability of changes; Lack of clarity on issues between Centre and States; Transaction oriented approach of the system instead of a corporate approach, leading to increased costs and delays; Lack of openness and transparency in communication and providing information." It is not that procedures have not improved anywhere, but the success greatly varies from State to State.

Credit problems – High interest rates and availability of credit are often cited as problems, as indeed they are. But one must be careful to separate out the price effect from a non-availability of credit problem. If combined Central and State-level deficits are as high as they are, not to speak of artificially high guaranteed rates of return on small savings, there will be upward pressures on interest rates. In a capital scarce country, real interest rates will never be as low as global interest rates, although this is qualified by the harmonization that has taken place between global and domestic interest rates. Some parts of the Indian corporate sector are now allowed to borrow globally, though not all. Why are real interest rates still so high? Other than deficits, small savings and cross-subsidization to priority sectors at administered rates of interest, one needs to highlight the interest spreads of banks. This masks inefficiencies in the banking system and significant non-performing assets (NPAs). On the latter, it is necessary to recognize that competition means free entry as well as exit. And there is a tendency to prevent exit, notwithstanding the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act. This locks up capital in unproductive sectors and units. Beyond the cost of credit issue, there are problems with availability of capital, not jus bank finance, but also through the stock market, and this includes venture capital. As a general proposition, too much capital flows to relatively larger units. There are collateral problems in the SSI sector.

[58] Many such studies suggest that transaction costs add around 20% to costs of doing business. However, these studies also tend to include infrastructure costs in transaction costs. That is, transaction costs are not procedural costs alone.

[59] This was chaired by Kumar Mangalam Birla.

The skills problem - The overall skills deficit has often been flagged. For instance, in 2002, the S.P. Gupta Special Group[60] constituted by the Planning Commission stated, "It should be noted, however, that on the average the skilled labour force at present is hardly around 6-8 per cent of the total, compared to more than 60 per cent in most of the developed and emerging developing countries." In 2001, the Montek Singh Ahluwalia Task Force[61], again constituted by the Planning Commission, stated, "Only 5% of the Indian labour force in this age category[62] has vocational skills whereas the percentage in industrial countries is much higher, varying between 60% and 80%, except for Italy, which is 44%. The percentage for Korea, which has recently been categorized as an industrialized country, is exceptionally high at 96%. The developing countries listed have percentages which are significantly lower than the developed countries, but they are still much higher than India e.g. Mexico at 28% and Peru at 17%. Differences in definition may make inter-country comparison somewhat unreliable, but the level in India is clearly far too low." While the numbers are marginally different, the Eleventh Five Year Plan document adds the following.[63] "The NSS 61st Round results show that among persons of age 15-29 years, only about 2% are reported to have received formal vocational training and another 8% reported to have received non-formal vocational training indicating that very few young persons actually enter the world of work with any kind of formal vocational training. This proportion of trained youth is one of the lowest in the world. The corresponding figures for industrialized countries are much higher, varying between 60% and 96% of the youth in the age group of 20-24 years. One reason for this poor performance is the near exclusive reliance upon a few training courses with long duration (2 to 3 years) covering around 100 skills. In China, for example, there exist about 4000 short duration modular courses which provide skills more closely tailored to employment requirement." If more numbers are needed, the following drive home the point.[64] 80% of new entrants into the work force have no opportunities for development of skills. While there are 12.8 million new entrants into the work force every year, the existing training capacity is 3.1 million per year. In both rural and urban India, and for both males and females, attendance rates in educational institutions drop by around 50% in the age group of 15-19 years.[65] Simultaneously, labour force participation rates begin to increase in the age group of 15-19 years and by the time it comes to the age group of 25-29 years, it is 95.0% for rural males and 94.4% for urban males. The figures for females are lower at 36.5% in rural India and 22.1% in urban India. The 15-29 age-group can be used as an illustration. Since post-educational institution training opportunities are limited, 87.8% of the population in this bracket has had no vocational training.[66] Of the 11.3% who received vocational training, only 1.3% received formal vocational training.[67] "The said results also reflect that 38.8% of the Indian labour force is illiterate, 24.9% of the labour force has had schooling up to the primary level and the balance 36.3% has had schooling up to the middle and higher level. They also reveal that about 80% of the workforce in rural and urban areas do not possess any identifiable marketable skills."[68]

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[60] *Report of the Special Group on Targeting Ten Million Employment Opportunities per year over the Tenth Plan Period*, Planning Commission, May 2002, http://planningcommission.nic.in/aboutus/committee/tsk_sg10m.pdf

[61] *Report of the Task Force on Employment Opportunities*, Planning Commission, July 2001, http://planningcommission.nic.in/aboutus/taskforce/tk_empopp.pdf

[62] 20-24 age-group.

[63] *Eleventh Five Year Plan, 2007-2012, Vol. I, ibid.*.

[64] *Ibid.* These numbers are based on the 61st round (2004-05) of the NSS.

[65] The drop is sharper for rural females and is higher in rural than in urban India.

[66] 85.5% for males and 90.2% for females. Understandably, the numbers without training are higher in rural areas.

[67] The number is higher for males and higher in urban than in rural areas.

[68] *Ibid.*

Policy constraints that prevent urbanization and formalization – The 2001 Census shows that 74.27% of India's population lives in rural India, while 25.73% lives in urban India. There are 384 urban agglomerations, 5161 towns, 27 million-plus cities and 35 million-plus urban agglomerations. An urban agglomeration is a continuous urban spread with a city, and its adjoining urban growth. There are some areas that are classified as towns in a statutory way, in the sense that a municipality, corporation, Cantonment Board or notified town area committee exists. More generally, the Census defines "urban" as an area with a minimum population of 5000, with at least 75% of the male working-age population engaged in non-agricultural pursuits and a population density of at least 400 per sq km. More to the point, there are 638,365 villages, some of which are uninhabited. More relevant is the number of inhabited villages in 2001, at 593,643. Should one plan for people to stay in rural India or should one plan for an urban India, remembering that urbanization is slower in India than in many parts of the developing world? Not only is urbanization lower in India than in developed countries, and even in several developing countries, it has also slowed over the decades. For instance, between 1971 and 1981 the annual average rate of urbanization was 3.79%, but declined to 3.09% between 1981 and 1991 and to 2.73% between 1991 and 2001.[69] There are several reasons why villages disappear. Thanks to migration and improved connectivity, some disappear. Others become mainstreamed into urban agglomerations. Still others are reclassified as urban as development proceeds. All these are desirable developments. The average population in an Indian village is 1,161 and this doesn't make the village viable, to provide physical or social infrastructure. 91,555 of India's villages have population sizes less than 200 and 12,644 of them are in Orissa, with other large numbers in Himachal, Uttaranchal, Rajasthan, UP, Jharkhand and MP. Another 127,515 of villages have population sizes less than 499; 14,806 have population sizes more than 5000; and 3,962 have population sizes more than 10,000. The idea is not to have a quota on the number of villages. Instead, the argument is that if urban planning is properly undertaken, more than 200,000 of India's villages will disappear, as they should, and there will be larger villages or towns with populations upwards of 10,000 and approaching and even crossing 100,000. There are three kinds of resistance articulated against this rural to urban transition. The first is a sentimental kind of association with some notion of a rural Arcadia. It is also worth mentioning that several studies have documented the pro-urban bias in subsidy delivery systems. The second kind of argument is based on the premise that with this transition, India will no longer be able to feed its increasing population. This fails to appreciate the low productivity levels Indian agriculture possesses, not only in comparisons with the rest of the world, but also in comparisons between India's irrigated and non-irrigated areas, with irrigation having so far benefited only 45% of the cultivated area. If required agricultural reforms are introduced, India will have no problems in feeding double its present population. The third argument is directed against the kind of urban life that is delivered, with pressures on urban infrastructure like water supply, sewage clearance and drainage, waste disposal, transportation, power, housing, law and order and environmental pollution issues. After all, the slum population in 2001 was estimated to be 61.82 million, with 640 towns reporting slum populations.[70] This is less an argument against urbanization and is more of an argument against the kind of urbanization that has taken place. 68.9% of the urban population is in Category I cities and 37% of the urban population lives in the 35 million-plus cities. Indeed, urbanization has been occurring in these mega cities.[71] The point is that both push and pull factors are distorted. They are

[69] There was an earlier period of decline between 1951 and 1961, but that was because some towns were declassified.

[70] Census 2001 figures.

[71] One should recognize that there is a reclassification effect here too. But this only explains part of the phenomenon. Indian censuses classify urban areas by size class of towns – I (more than 100,000), II (50,000 to 100,000), III (20,000 to 50,000), IV (10,000 to 20,000), V (5,000 to 10,000) and VI (less than 5,000).

distorted in terms of preventing urbanization and creating disincentives against rural to urban migration. And they are also distorted in terms of creating the wrong kind of urbanization. If these policy-induced distortions are removed, the right kind of rural to urban transition will occur. For instance, State-government policies prevent creation of rural land markets and work against acquisition of agricultural land and its conversion to non-agricultural usage. Understandably, this is linked to issues of compensation, resettlement and rehabilitation and devising alternative rural or urban livelihoods, a controversy witnessed in recent SEZ (special economic zone) and non-SEZ debates. States are reluctant to notify rural settlements as towns, because many subsidies and grants from the Centre are geared towards retaining rural status. Urban land markets are also distorted through State intervention. Most land is publicly owned and does not come on to the market. This creates artificial shortages and housing and real estate shortages are compounded by dysfunctional building (and tenancy) laws. For instance, even for the slums, it is possible to un-bundle ownership and create rights for the poor, so that incentives are created for improvement, including loans and the offering of collateral. Urbanization should also lead to formalization and employment in the organized sector. Indian data have a fuzzy category called self-employment and in 2004-05, 56.5% of the work force reported itself as being self-employed. In the non-agricultural work force, 62.8% of workers reported themselves as self-employed.[72] There are also wide inter-State variations. For instance, more than 65% of non-agricultural workers reported themselves as self-employed in Andhra Pradesh (65.2%), Assam (65.6%), Bihar (80.8%), Jammu and Kashmir (73.7%), Madhya Pradesh (65.5%), Orissa (70.3%), Uttar Pradesh (68.1%), West Bengal (68.2%) and Uttarakhand (67.2%). In contrast, the figure was lower than 50% in Himachal Pradesh (48.4%) and Kerala (47.9%). The higher the degree of self-employment, the lower is the prosperity of the State. This suggests that self-employment is not a viable occupational category at all. It is a subsistence-level occupation because people cannot afford to remain unemployed.[73] Outside of agriculture, the total self-employed population is 92.1 million. Some of these are in relatively high income occupations, like independent professionals (doctors, lawyers, artists, accountants), shop owners in urban areas, rice-mill owners, workshop owners, commission agents, real estate and housing brokers and owners of small hotels and restaurants. But others are in relatively low income occupations, like handloom weavers (mostly women), *chikan* workers (mostly women), street vendors, food processors, rickshaw pullers, rag-pickers, *beedi* rollers (mostly working out of home), *agarbatti* makers (mostly women), potters and bamboo product makers.[74] Self-employed workers in the relatively low income categories would be better off in wage employment, such as in manufacturing. 87% of own account enterprises are actually in rural areas, which is why the rural transformation also becomes important. The average own account enterprise is low on assets and low on value addition. The average value addition is Rs 2175 per month in urban areas and Rs 1167 per month in rural areas. Depending on the family size, this is not enough to ensure livelihood above the poverty line. 84.9% of own account enterprises are not registered and this needs to be flagged, because registration also brings attendant benefits, such as access to credit or government subsidies on marketing and technology. Why aren't own account enterprises registered? The answer isn't entirely lack of information. Opting out of registration is probably a conscious decision, because the benefits from registration are not commensurate with the costs. Not only are procedures connected with registration complicated and tiresome, registration brings with it the attendant problem of bribery and rent-seeking from the government machinery. For instance, for rickshaw pullers and street-vendors, studies in

[72] More accurately, they reported themselves as own account workers. *Report on Conditions of Work and Promotion of Livelihood in the Unorganized Sector*, *ibid.*.

[73] In rural areas, self-employment is more among women. In urban areas, the figures are similar for both males and females.

[74] *Report on Conditions of Work and Promotion of Livelihood in the Unorganized Sector*, *ibid.*

many parts of urban India have documented harassment and bribery by municipal authorities and police.[75]

Section 4: The infrastructure deficit

In addition to the problems mentioned in Section 3, one should now specifically mention infrastructure in a separate section. Infrastructure means several different things and there can be no quarrel with the proposition that inadequate infrastructure renders Indian manufacturing uncompetitive. As a generalization, the infrastructure area where there have been visible improvements is telecom, with roads perhaps following as a somewhat distant second. The contours of unbundling, user charges and regulatory agencies are known. The issue is simply one of getting infrastructure reforms implemented and some areas of physical infrastructure are State subjects. From the manufacturing perspective, perhaps the most important infrastructure areas are power, ports and railways, followed by roads. The issues are twofold. First, given scarce government resources, where are these best deployed? Second, again given scarce government resources, what is the scope for private sector involvement? The Eleventh Plan document states, "Good quality infrastructure is the most critical physical requirement for attaining faster growth in a competitive world and also for ensuring investment in backward regions. This includes all-weather roads; round-the clock availability of power at a stable voltage and frequency; water for irrigation; railways that are not overcrowded, which run on time and do not overcharge for freight; ports with low turnaround time to reduce costs of imports and exports; airports to handle the growing traffic; air services that provide connectivity to all parts of the country; and telecommunications and broadband connectivity to provide the benefits of the Internet to people all over the country."[76] It is impossible to disagree with this objective, or with the intention of increasing investment on infrastructure from 5.43% of GDP in 2006-07 to 9.34% in 2011-12. NMCC's afore-mentioned Strategy document states, "Power supply remains the main physical infrastructure bottleneck to industrial growth on account of chronic shortages, high cost and unreliability. The average manufacturer in India loses 8.4 per cent a year in sales on account of power outages as opposed to less than 2 per cent in China and Brazil. The adverse impact on similar units in the unorganized sector could be higher. It is estimated that power shortage alone contributed to a production loss of at least one per cent of GDP."[77] "Power supply remains the main physical infrastructure bottleneck to industrial growth on account of chronic shortages, high cost and unreliability. The average manufacturer in India loses 8.4 per cent a year in sales on account of power outages as opposed to less than 2 per cent in China and Brazil. The adverse impact on similar units in the unorganized sector could be higher. It is estimated that power shortage alone contributed to a production loss of at least one per cent of GDP. Power supply remains the main physical infrastructure bottleneck to industrial growth on account of chronic shortages, high cost and unreliability. The average manufacturer in India loses 8.4 per cent a year in sales on account of power outages as opposed to less than 2 per cent in China and Brazil. The adverse impact on similar units in the unorganized sector could be higher. It is estimated that power shortage alone contributed to a production loss of at least one per cent of GDP."[78]

[75] Manushi's work is but one example. See, Madhu Purnima Kishwar, *Deepening Democracy, Challenges of Governance and Globalization in India*, Oxford University Press, 2005.
[76] *Vol. I, ibid.*
[77] *Ibid.*
[78] *India: Private Sector Strategy for the World Bank Group, http://siteresources.worldbank.org/INTINDIA/Resources/Annexure7.pdf*

One need say no more on infrastructure and the need for reform. But one should perhaps mention attempts to ensure skill formation and develop physical infrastructure by focusing on clusters. There are two related strands that feed into the notion of developing growth poles. First, there is quite a bit of cross-country evidence that shows that small firms thrive and prosper, despite economies of scale and scope and technological advantages associated with large firms. Italy is not the only example. Small firms exhibit flexibilities that large firms are unable to match. Hence, there are also diseconomies of scale. However, small firms also suffer from disadvantages. There are asymmetries in the capital market, imperfect knowledge about demand conditions, lack of marketing information and marketing resources and inadequate access to technology and skills. All these involve fixed costs that are difficult for a small firm to bear alone. But when clusters or hubs develop, there are external economies of both scale and scope and both fixed and variable costs can be spread over a broader base. Small firm flexibilities are thus best exploited when such clusters and hubs develop and UNIDO (United Nations Industrial Development Organization), ILO (International Labour Organization), UNCTAD (United Nations Commission on Trade and Development), UNESCO (United Nations Educational, Social and Cultural Organization), OECD (Organization of Economic Cooperation and Development), the World Bank and assorted other organizations have all taken an interest in promoting clusters in developing countries in Asia, Africa and Latin America. The second strand that feeds into the growth pole idea is the recognition that rural employment generation has been unsatisfactory in India since the 1991 reforms started.

The idea of cluster formation isn't new. Ever since the Industrial Policy Resolution of 1948, successive Five-Year Plans and promotional schemes have tried to push growth poles. For instance, the First Five Year Plan had the Rural Industrial Estate Programme and the Village Artisan-Oriented Programme. The Second Five Year Plan had the Common Production Programme and the Pilot Project Programme. The Third Five Year Plan had the Rural Industries Project Programme. The Fourth Five Year Plan had the Rural Artisan Programme. The Fifth Five Year Plan had the District Industries Centre Programme and the Backward Area Scheme. The Sixth Five Year Plan had the Growth Centre Programme. The Eighth Five Year Plan had the Integrated Infrastructural Development Programme. And the Ninth Five Year Plan had the National Programme for Rural Industrialization. That apart, there is the Cluster Development Programme, spearheaded by UNIDO. Specifically, under the National Programme for Rural Industrialization, there was an objective of setting up 100 rural clusters every year, pushed by KVIC, SIDO, SIDBI and NABARD. Before undertaking a fresh cluster development exercise, one therefore needs to ask, why have earlier attempts not succeeded? And why will new efforts be different? There are two possible reasons for earlier failures. First, there are clusters and clusters. At a conceptual level, there are three kinds of clusters one can visualize – relatively modern, small-firm dominated industrial clusters that often tend to be located in relatively urban areas; artisan and rural industry based clusters; and clusters that are based on the agro-economy. Arguably, most policy interventions have focused on the first of the three, rather than the last two. Second, policy interventions and developmental programmes have tended to be ad hoc, rather than taking a holistic view of what is necessary. For instance, if infrastructure is not developed and development of skills remains a question mark, it is doubtful that marketing interventions alone will suffice. Stated differently, policy interventions alone won't be sufficient to ensure that clusters develop. Nor should one forget that industrial clusters often tend to be located in the relatively more advanced parts of the country. In contrast, artisan-based or agro-based clusters are more evenly distributed spatially.

There are already some policy initiatives directed towards identifying and promoting cluster development. First, there are the industry clusters proper. UNIDO has identified around 300 industrial clusters across India and is in the process of developing 200 more. As

mentioned earlier, these clusters tend to be concentrated in certain geographical regions. UNIDO has identified sectoral cum geographical clusters in leather (Amber), drugs and pharmaceuticals (Ahmedabad), machine tools (Bangalore), hand printing and dyeing (Sanganer & Bagru), food processing (Pune), cotton knitwear (Tirupur) and woolen knitwear (Ludhiana). The S.P. Gupta Committee (the Special Group) on generating employment identified four clusters – the toy industry (Delhi and Mumbai), the stone industry (Rajasthan and Andhra Pradesh), the lock industry (Aligarh and Dindigal) and special purpose machine tools for the lock industry (Aligarh). The 2002-07 Exim Policy recognized three major industrial clusters and towns of export excellence in Tirupur, Panipat and Ludhiana and proposed to extend this identification to 10 clusters. An IDFC-McKinsey joint study identified high growth potential economic clusters in five broad geographical regions – Mumbai-Pune-Nasik, Delhi-Noida-Gurgaon, Chennai-Pondicherry-Bangalore, Hyderabad-Visakhapatnam and Kolkata and its hinterland. There is a SIDBI identification of clusters that are part geographical and part sectoral and this includes locks (Aligarh), foundry units (Howrah), bicycle/bicycle parts (Ludhiana), scientific instruments (Ambala), salt and salt based chemicals (Saurashtra/ Kutch), powerloom (Surat/ Bhiwandi), machine tools (Rajkot), rubber products (Kottayam), glassware (Firozabad), brass and bell metal (Kantilo), blacksmithy (Mylliem), leather and leather products (Barabanki/ Sitapur/ Hardoi/ Unnao), terracotta (Dhubri), hand tools (Jalandhar), auto-components (Pune), shoe making (Nongstoin). Industry Ministry has a list of 100 clusters identified for development. Such identifications do not have a specific employment focus. For instance, if one were to be interested in pushing employment, one would pick sectors like food processing, textiles and garments, leather and leather products and footwear. Stated differently, if one were to consider the 100 clusters already identified by Industry Ministry and matched them against the employment potential, one would probably pick garments (Rayadurg (Andhra Pradesh), Delhi, Guwahati (Assam), Bellary (Karnataka)); leather (Vijayanagaram, Jammapur, Warangal (all Andhra Pradesh), Gujarat); and food processing (Arunachal Pradesh, Himachal Pradesh, Srinagar, Jharkhand, Shillong (Meghalaya)), but not necessarily any of the others.

Second, UNIDO and the government have also identified 1600 artisan clusters, which are not quite the relatively modern industrial clusters. These are spatially distributed much more evenly throughout the country and can also feed into the 15,000 retail outlets that KVIC possesses. If one tracks the 100 clusters already identified by Industry Ministry, one finds that only woodcraft (Jagdalpur (Chhattisgarh), wood packaging (Srinagar), woodcraft (Madhya Pradesh), handlooms (Shillong), handlooms (Aizwal (Mizoram) and cane and bamboo (Dimapur (Nagaland)) fit the artisan cluster category. One should not forget that the employment potential of the artisan sector is considerable.

Third, one should mention the relatively ignored angle of agro-based clusters, ignored except when there is an attempt to push agro export processing zones (AEPZs), such as pineapples (Jalpaiguri, West Bengal), Gujarat, Chittoor (Andhra Pradesh), Karnataka, Tamil Nadu, Udham Singh Nagar (Uttaranchal) and Nagpur, Amaravati, Ratnagiri, Sindhudurg, Aurangabad (all Maharashtra). But one should also mention the estimated 47,000 *haat*s in the country and the estimated 7161 regulated *mandi*s. Most of these suffer from inadequate infrastructure and are also characterized by scope of dis-intermediation, which an experiment like ITC's *e-choupal* attempts to tap.

Section 5: Inter-State differences

In earlier sections of the paper, there have been indirect references to the disparities within India, including those across States. It is important to make this explicit, since generalizations on an all-India basis are likely to be misleading. Internal policy constraints

can often be State-specific, though some are also generic in nature. Inter-State disparities have increased post-1991 and have also been commented on, the issue of convergence vis-à-vis divergence between States being a contentious issue. There are different ways to look at the economic geography of a country, depending on the administrative division one has in mind. State administrative boundaries are natural dividing lines to use. Academic work and popular impression have often used the BIMARU (Bihar, Madhya Pradesh, Rajasthan, Uttar Pradesh) nomenclature, with a pun on the word *bimar*, meaning ill or sick. While this is still useful as a starting-off point, the States of Bihar, Madhya Pradesh and Uttar Pradesh have now been sub-divided and Orissa is often worse than some of these four traditional BIMARU States. BIMARU thus becomes BIMAROU, not to speak of deprivation, according to some indicators, in Jammu & Kashmir and the North-East. Although undivided Madhya Pradesh and Rajasthan are no longer as deprived and backward as Bihar and the eastern parts of Uttar Pradesh, and Uttarakhand is better off than Uttar Pradesh, many of these traditionally backward areas tend to be concentrated in the North. In understanding India's development, especially after the 1991 reforms, one thus tends to often use a North-South framework. Two simple explanations are often used to explain this phenomenon. First, in the pre-1991 era, when licensing and proximity to the centre that granted licenses was important, the North performed relatively better. With licensing having disappeared, at least for manufacturing, this relative advantage has vanished and the South has come into its own. Second, given the inadequacy of internal transport infrastructure, coastal regions, where this inadequacy is less manifest, tend to flourish. While both these arguments have a grain of truth, and property rights that govern land are also important, this North-South dichotomy is a trifle too simplistic, as is the East-West dichotomy, with a dividing line vertically drawn between Kanpur and Chennai, regions to the West of this line performing better than regions to the right. Indeed, the use of State boundaries to facilitate our understanding is itself somewhat flawed, since development and deprivation do not follow such administrative distinctions. However, there is an in-built bias in favour of using States, since data problems are easier to handle then. Data problems become more difficult to overcome if one thinks of India's regions, or even districts and villages. While it is difficult to obtain satisfactory data on exports or FDI disaggregated State-wise, some data are indeed available, at least for the major States. These show the expected story of Central and Eastern India being bypassed.

Table 5 shows some indicators across States for external sector specific areas. The first column in the table shows the export shares of States and the concentration in Maharashtra, Gujarat, Tamil Nadu and Karnataka is obvious.[79] The second column shows the share of these States in FDI equity inflows from April 2000 to June 2009.[80] FDI inflow trends have varied over time. Consequently, a State's share is also a function of the time period being considered. Table 5 focuses on the period since 2000, which is when a take-off of sorts occurred in India's FDI inflows. And for this period, FDI inflows are concentrated

[79] These figures are from *Economic Survey, 2008-09*, Department of Economic Affairs, Ministry of Finance, Government of India. These are figures on exports of goods alone, sourced from DGCIS (Directorate General of Commercial Intelligence & Statistics). Have figures on services also been included, the shares of some of the southern States would have been higher. There are quality problems with these data that one shouldn't ignore. This is one reason why such figures weren't available until recently.

[80] http://www.dipp.nic.in/fdi_statistics/india_FDI_June2009.pdf. There is a data issue here too, and the numbers are therefore approximate, if one is trying to distribute them in accordance with States. The data are collected through RBI's regional offices and the regional office for Mumbai handles not only Maharashtra, but Dadra & Nagar Haveli and Daman & Diu too. In that sense, Table 2 marginally over-estimates the shares of the States listed in the table. However, since only major States are listed in Table 2 and the intention is to indicate variations across the major States, the distortions aren't enormous. There is a special problem for the Chandigarh office, which covers both Punjab and Haryana. The two States together accounted for a share of 0.4% and we have simply divided this equally in the table.

in Maharashtra, Gujarat, Tamil Nadu, Karnataka, Andhra Pradesh and Delhi. The third column in Table 3 gives a distribution of notified SEZs (special economic zones).[81] The concentration in the west and the south is again very obvious. The SEZ policy has been extremely controversial, largely because of the distortions it causes in land markets, with land acquisition, compensation, resettlement and rehabilitation contentious subjects. There have been fiscal concessions too. A long quote illustrates what the government expects the SEZ policy to achieve. "Another major policy issue in the trade sector which was debated was that of SEZs. The SEZ Act, 2005, supported by SEZ Rules, came into effect on February 10, 2006. The main objectives of the SEZ Act are generation of additional economic activity, promotion of exports of goods and services, promotion of investment from domestic and foreign sources, creation of employment opportunities and development of infrastructure facilities. Various incentives and facilities are offered to units in SEZs for attracting investments into SEZs (including foreign investment) as well as for SEZ developers. These incentives and facilities are expected to trigger a large flow of foreign and domestic investment in SEZs, particularly in infrastructure and productive capacity, leading to generation of additional economic activity and creation of employment opportunities. The SEZ Rules provide for different minimum land requirements for different classes of SEZs. Every SEZ is divided into a processing area where alone the SEZ units are set up and a non-processing area where the supporting infrastructure is to be created. The SEZ Rules also provide for simplified procedures for development, operation and maintenance of the SEZ and setting up units in SEZs, single window clearance both relating to Central as well as State Governments for setting up of an SEZ and units in a SEZ and simplified compliance procedures/documentation with emphasis on self-certification. As on May 13, 2009 as many as 568 SEZs have been accorded formal approval and 318 SEZs have been notified."[82] Other than SEZs, a central scheme known as ASIDE (Assistance to States for Developing Infrastructure and Allied Activities) is also available to States to help develop export infrastructure.

Table 5: Inter-State Performance

	Export share (%), 2007-08	Share in FDI equity flows, April 2000-January 2009	Notified SEZs
Maharashtra	27.5	37.1	55
Gujarat	21.3	6.3	27
Tamil Nadu	9.1	5.5	49
Karnataka	9.0	6.6	27
Andhra Pradesh	4.6	4.0	68
West Bengal	3.5	1.4	11
Delhi	3.2	16.9	
Haryana	2.7	0.2	30

[81] http://www.sezindia.nic.in/HTMLS/Statewise%20Distribution%20-%20SEZ%2019.6.09.pdf. This is a listing of notified SEZs. There are others that have been granted approvals, but haven't been notified. Those aren't included in the table. Since only major States are included in Table 2, some notified SEZs are missing from the table, such as those for Chandigarh or Chhattisgarh. Delhi has no SEZs.

[82] *Economic Survey, ibid.*

Uttar Pradesh	2.6	0.1	16
Orissa	1.9	0.1	6
Rajasthan	2.0	0.5	7
Punjab	1.6	0.2	2
Madhya Pradesh	1.8	0.2	5
Kerala	1.5	0.3	11
Goa	0.9	0.3	3

However, the intention of this section is not to get into the SEZ debate, but to highlight inter-State differences. There have been several studies on inter-State differential performance, especially after 1991. Some of these focus on human development (per capita income, poverty ratios, others on growth rates and still others on investment attractiveness of States. For instance, a recent World Bank paper reviews the investment climate in 16 Indian States.[83] This is important because of the following. "Five states with 44% of India's population in 1996 will contribute 55% of population growth in the period 1996 to 2016. Performance of these states will determine the year and size of population at which country achieves the replacement level of fertility and later population stabilization."[84] These five States are Bihar, Uttar Pradesh, Madhya Pradesh, Rajasthan and Orissa, the first three representing the States in undivided form. Out of the rural labour force of roughly 300 million, 72.7% still earns a living from agriculture.[85] But the figure is less than 50% in Kerala, Tripura, Tamil Nadu, West Bengal and Punjab and is more than 65% in Assam, Madhya Pradesh, Mizoram, Bihar, Meghalaya, Arunachal Pradesh and Chhattisgarh. The pace of decline, as opposite to the base figures, has been sharpest in Kerala, Himachal Pradesh, Haryana, Rajasthan, Punjab and West Bengal and has been the slowest in Orissa, Bihar, Madhya Pradesh, Andhra Pradesh and Karnataka.[86] As Table 6 shows, amongst the youth, most of those with formal training are in Kerala, Maharashtra, Tamil Nadu, Himachal Pradesh and Gujarat.[87] Not surprisingly, Bihar's share is the lowest. A better indicator of the State's performance is the share of the young population that has some variety of formal training. In this, Maharashtra, Kerala, Tamil Nadu, Gujarat and Andhra Pradesh perform well. Is this because there is better training capacity and infrastructure? Is it because industrial activity exists in these States? Is it because there is a positive correlation between some minimum level of educational attainment and acquisition of formal training? The answer is probably a combination of various factors.

[83] "The Investment Climate in 16 Indian States," Giuseppe Iarossi, *Policy Research Working Paper 4817*, World Bank, January 2009. The World Bank's "Doing Business" database also ranks cities, though not quite States, in terms of the indicators used in doing business rankings.
[84] National Commission on Population, http://populationcommission.nic.in/facts1.htm
[85] *Report on Conditions of Work and Promotion of Livelihood in the Unorganized Sector*, *ibid*.
[86] *Ibid.*
[87] *Skill Formation and Employment Assurance in the Unorganized Sector*, NCEUS, August 2008.

Table 6: Inter-State Variations in Skill Formation Among Youth, 15-24, 2004-05

State	Share of State in those with formal training (%)	% youth in State with formal training
Jammu & Kashmir	0.4	2.0
Himachal Pradesh	1.0	5.6
Punjab	2.8	4.1
Uttarakhand	0.8	3.9
Haryana	2.8	4.5
Delhi	1.7	4.1
Rajasthan	2.5	1.7
Uttar Pradesh	6.9	1.7
Bihar	0.8	0.5
Assam	0.8	1.4
West Bengal	6.9	3.2
Jharkhand	0.8	1.3
Orissa	1.9	1.9
Chhattisgarh	2.0	3.5
Madhya Pradesh	3.4	2.2
Gujarat	6.6	4.7
Maharashtra	21.7	8.3
Andhra Pradesh	6.6	3.2
Karnataka	4.6	3.1
Kerala	12.2	15.5
Tamil Nadu	11.3	7.6
North-East	0.4	1.3
Union Territories	1.3	12.6

There is no need to review the fairly extensive literature that exists on inter-State differences. Instead this section now reports a ranking done by Bibek Debroy and Laveesh

Bhandari. This has been done for ten years now, following the same methodology.[88] If one wants to rank States, there are two broad roads to follow. First, one can administer questionnaires and respondents reply to specific questions. However, this route presumes that respondents know about all the States one wishes to rank. Typically, that doesn't happen. Respondents know about States they operate in (or are located in). Second, one can use objective data. (There's a third alternative of splicing subjective and objective, but that's neither here nor there.) This ranking uses the objective route, relying solely on data from Central sources, so that non-comparability of data across States is not an issue. The next step is to identify the parameters to rank States. This ranking uses eight heads. Prosperity and budget (percentage of population above poverty line, percentage of urban population, per capita capital expenditure, inflation, per capita debt, per capita GSDP (gross State domestic product), per capita revenue of SEBs (State Electricity Boards); law and order (number of policemen per lakh people, ratio of cases filed to pending cases in district and lower courts, share of murders, kidnappings, rapes and molestations to total cognisable crimes); health (infant mortality ratio or IMR, ratio of male IMR to female IMR, percentage of births assisted by trained personnel, percentage of homes having tap water as principal source of water, registered doctors per million population, sex ratio and per capita expenditure on health and family welfare by state Government); education (literacy rate, proportion of 10-plus children having completed primary education, ratio of boys to girls in elementary school, teacher-pupil ratio and expenditure on elementary education per 6 to 14-year-old); consumer markets (households owning TVs, number of affluent households in urban and rural areas, per capita deposits in banks and per capita ownership of two-wheelers); agriculture (percentage of cultivated area under cash crops, agriculture GSDP per rural population, agriculture electricity consumption per rural population, food-grain yield, loans extended to farmers and net irrigated area); infrastructure (percentage of homes with electricity, percentage of villages connected with *pucca* roads, per capita road length, bank branches, LPG connections, post offices and telephones); and investment environment (per capita capital expenditure, commercial bank credit and gross capital formation in manufacturing, ratio of factories to number of disputes, ratio of industrial workers to urban 15-59 population, and percentage of sick SSIs (small-scale industries). Data on all the parameters are normalized. Different variables move in different directions. So to obtain a State's performance under any one head, variables have to be aggregated. This is done through principal components analysis, which churns out weights in the estimation process itself. Accordingly, for each head, there are scores for each State. Using these scores, States are ranked for each head. That not only gives an inter-State comparison, but also tells us how a State performed in 2009 compared with earlier years. But one should not read too much into ranks. It is the scores that are crucial. There may be little difference in scores for two States, although one is ranked above the other. In such cases, the ranking is not robust. If the difference in scores is large, one can read much more into ranks. But the overall score is also important. Hence, the eight heads are aggregated into an overall performance index for each State. For this aggregation, the equal weight aggregation is reported, since in this case, there is little difference between equal weights and principal component weights. With these preliminaries, the findings are reported in Table 7. In Table 7, the rankings are only given for major or large States.[89]

[88] For the last seven years, it has been done for *India Today*, under the name "State of the States". The 2009 version is available in the *India Today* issue dated 28th September 2009. For the three years before *India Today*, it was done for CII (Confederation of Indian Industry).

[89] Large States are defined as those that have an area more than 35,000 sq km and a population more than 5 million. Rankings for small States and UTs (Union Territories) are given in *India Today.*

Table 7: Inter-State Rankings, 2009

	Overall rank	Primary health rank	Primary education rank	Prosperity & budget rank	Law & order rank	Consumer markets rank	Infrastructure rank	Investment environment rank	Agriculture rank
Punjab	1	7	9	2	14	1	1	3	1
Himachal	2	1	1	1	7	3	3	1	15
Tamil Nadu	3	4	5	6	2	8	6	5	3
Kerala	4	3	2	9	1	4	2	13	9
Gujarat	5	10	10	3	3	6	8	2	6
Haryana	6	12	13	4	12	7	5	8	2
Karnataka	7	6	8	8	4	9	7	6	5
Maharashtra	8	8	7	7	9	2	4	4	7
Jammu & Kashmir	9	2	4	5	11	5	9	9	14
Andhra	10	9	12	10	8	11	10	10	4
Uttarakhand	11	5	3	11	13	10	16	7	10
Rajasthan	12	13	17	14	6	12	11	16	12
Madhya Pradesh	13	14	15	17	5	18	12	15	13
West Bengal	14	11	11	13	20	14	13	18	11
Assam	15	15	6	16	17	13	17	19	20
Chhattisgarh	16	19	16	12	10	17	19	11	18
Orissa	17	17	14	18	16	19	15	14	17
Uttar Pradesh	18	18	19	19	18	16	14	17	8
Jharkhand	19	16	18	15	15	15	20	12	19
Bihar	20	20	20	20	19	20	18	20	16

Table 7 shows why one has to be a bit careful when using expressions like convergence or divergence across States. To a large extent, the answer is a function of the variable used to measure differentiation. However, the variability across States is enormous. For instance, between 2000-01 and 2007-08, the annual average real rate of GSDP growth was 7.8% for India, masking disaggregated growth of 10.22% in Gujarat and 4.84% in Madhya Pradesh. 99% of households in Punjab have electricity connections, while the figure for Bihar is 22%. Goa's per capita income is almost ten times that of Bihar. 39.9% of Orissa's population is below the poverty line, while the figure is 4.2% in Jammu and Kashmir. 72.6% of Himachal's households possess television sets, while the figure is 18.2% in Bihar. To dramatize what is happening, let us consider the following.[90] Let us assume an all-India real GDP growth rate of 8% till 2020 and let us assume this growth (in income and in population) is distributed among the States in the ratio that it is distributed in today. Let us now project the per capita income of Indian States in the year 2020, using PPP (purchasing power parity) US dollars, assuming that the exchange rate continues to be what it is today. This gives the following list of PPP per capita dollar income figures in 2020 – Chandigarh (36,926), Puducherry (34,583), Goa (29,074), Delhi (26,702), Karnataka (13,127), Maharashtra (12,075), Gujarat (11,782), Tamil Nadu (11,641), Haryana (10,297), Punjab (10,205), Himachal Pradesh (9,534), West Bengal (8,873), Andaman & Nicobar Islands (8,229), Kerala (8,007), Andhra Pradesh (7,351), Tripura (7,301), Meghalaya (7,122), Manipur (6,246), Rajasthan (6,048), Nagaland (4,908), Jammu & Kashmir (4,212), Arunachal Pradesh (3,837), Jharkhand (3,437), Chhattisgarh (2,928), Madhya Pradesh (2,864), Uttar Pradesh (2,750), Orissa (2,658), Assam (2,559), Bihar (1,698) and all-India (7,587). Measured in accordance with the per capita income criterion, this tells us what are going to be India's richest and poorest States. It also tells us there is going to be a serious inter-State disparity problem, unless something changes. These results can also be presented in a slightly different way. Which countries in the world have similar PPP per capita income figures today? And the list is - Chandigarh (USA), Puducherry (USA), Goa (Switzerland), Delhi (Japan), Karnataka (Czech Republic), Maharashtra (Saudi Arabia), Gujarat (Saudi Arabia), Tamil Nadu (Saudi Arabia), Haryana (Slovak Republic), Punjab (Slovak Republic), Himachal Pradesh (Chile), West Bengal (Mexico), Andaman & Nicobar Islands (Costa Rica), Kerala (Russia), Andhra Pradesh (Brazil), Tripura (Brazil), Meghalaya (Belarus), Manipur (Thailand), Rajasthan (Colombia), Nagaland (Peru), Jammu & Kashmir (China), Arunachal Pradesh (China), Jharkhand (Sri Lanka), Chhattisgarh (Indonesia), Madhya Pradesh (Azerbaijan), Uttar Pradesh (Azerbaijan), Orissa (Zimbabwe), Assam (Zimbabwe), Bihar (Bangladesh) and all-India (Brazil). In PPP per capita income terms, the India of 2020 will be like the Brazil of today, not like the Brazil of 2020. And this is per capita income alone. No one is suggesting that in 2020, Assam will have the kind of life expectancy Zimbabwe has today. There are also significant disparities within States. Most backward districts, identified by any criterion, are geographically contiguous and are also associated with violent movements. If one considers these backward districts, one notices that these are generally concentrated in Central India, extending eastwards, and going all the way up to the North-East, thus reinforcing the earlier impression. India cannot prosper if significant sections of India continue to be bypassed and marginalized. The Institute for Conflict Management has a map of conflict in South Asia, through its South Asia Terrorism Portal.[91] This map shows an obvious correlation between deprived districts and intensity of terrorism or violence, at least at the all-India level. Apart from Jammu and Kashmir, which belongs to a special category, this correlation is obvious for the central parts of India,

[90] These computations are based on "The North Versus the Rest, Where Do We Stand Today? And Where Will We Go Tomorrow?" *PHD Policy Paper-V*, August 2006, jointly with Laveesh Bhandari.

[91] http://www.satp.org/satporgtp/icm/index.html

extending eastwards. There are spill-overs of cross-border terrorism and arguably, there is a strong correlation between collective violence and economic prosperity, or its lack.

Section 6: SAARC

The South Asian Association for Regional Cooperation (SAARC) is the largest regional organization in the world, with India, Pakistan, Bangladesh, Sri Lanka, Nepal, Maldives, Bhutan and Afghanistan (since 13th November 2005) as members, and with China[92], Japan, South Korea and the EU granted observer status and distant prospects of Iran eventually becoming a member[93]. SAARC should have been much more important as an entity. However, any realistic assessment should accept that SAARC is still somewhat irrelevant. Wikipedia is a fairly commonly used encyclopedia. On SAARC, Wikipedia offers the following.[94] "SAARC's inability to play a crucial role in integrating South Asia is often credited to the political and military rivalry between India and Pakistan. Though Bangladesh and Sri Lanka have much warmer relations with India, they fear that the more integrated South Asia is, the greater will be India's dominance over South Asian nations. It is due to these political and territorial disputes that South Asian nations have not been able to harness the benefits of a unified economy. Over the years, SAARC's role in South Asia has been greatly diminished and is now used as a mere platform for annual talks and meetings between its members." It is impossible to disagree with the general thrust, even with the last sentence.

What is SAARC? Is it a forum for advancing economic cooperation? Every SAARC Declaration now has significant sections on economic cooperation. The Report of the SAARC Group of Eminent Persons stated, "Looking at SAARC in retrospect, the group felt that the association had passed through two distinct phases. The first phase was the preparatory phase, based on a gradual and step-by-step approach to initiating regional cooperation, mostly in non-controversial and peripheral areas such as confidence-building measures. The Integrated Programme of Action (IPA) is an example of such an approach. It was during this phase that the minimum necessary institutional mechanisms were put in place for the operationalization of a limited number of activities under the SAARC framework. In the second half of the evolution, SAARC moved into its expansionary phase, when regional cooperation was expanded both in the social and core economic sectors. Many major commitments with far-reaching implications for the region, were undertaken, including the coming into force of the South Asian Preferential Trading Arrangement (SAPTA). However, the member states did not vest in SAARC either a sufficiency of political will or adequate resources for carrying out these commitments to ensure the expected level of effectiveness. As a consequence, a disjunction developed between the decisions taken by the association and their implementation."[95] If one reads the report, one finds significant sections on trade (meaning trade in goods), trade in services, investment and finance, infrastructure coordination, macroeconomic policy coordination and adopting common positions on global economic issues[96]. The Islamabad Declaration at the 12th SAARC Summit stated, "SAARC members should continue to safeguard their collective interests in multilateral forums by discussing, coordinating and exchanging information with a view to adopting common positions, where appropriate, on various issues."

[92] Unlike the other observers, China is interested in joining SAARC.
[93] This is unlikely in the immediate future, because of the nuclear issue.
[94] http://en.wikipedia.org/wiki/South_Asian_Association_for_Regional_Cooperation
[95] *SAARC Vision Beyond the Year 2000, Report of the SAARC Group of Eminent Persons*.
[96] The WTO is an instance of this. Joint Statements and Joint Declarations have characterized WTO Ministerial Conferences in Geneva in 1998, Seattle in 1999 and Doha in 2001.

Since the 6th Summit in Colombo in 1991, one of SAARC's achievements has been the SAARC Preferential Trading Arrangement (SAPTA), which was signed in 1993 and entered into force in 1995. This contemplated tariff reductions in successive and phased steps, while recognizing the special needs of LDCs and preferential steps in their favour. SAPTA was a prelude to the South Asian Free Trade Area (SAFTA), the SAFTA agreement was signed during the 12th Summit in Islamabad in 2004 and entered into force in January 2006. In simple terms, SAFTA will lead to a free trade area (FTA) by 2016[97]. Under an early harvest programme for LDCs, India, Pakistan and Sri Lanka will however reduce customs duties to 0-5% for imports from LDCs from January 2009. More specifically[98], "1.Contracting States agree to the following schedule of tariff reductions: a) The tariff reduction by the Non-Least Developed Contracting States from existing tariff rates to 20% shall be done within a time frame of 2 years, from the date of coming into force of the Agreement. Contracting States are encouraged to adopt reductions in equal annual installments. If actual tariff rates after the coming into force of the Agreement are below 20%, there shall be an annual reduction on a Margin of Preference basis of 10% on actual tariff rates for each of the two years. b) The tariff reduction by the Least Developed Contracting States from existing tariff rates will be to 30% within the time frame of 2 years from the date of coming into force of the Agreement. If actual tariff rates on the date of coming into force of the Agreement are below 30%, there will be an annual reduction on a Margin of Preference basis of 5 % on actual tariff rates for each of the two years. c) The subsequent tariff reduction by Non-Least Developed Contracting States from 20% or below to 0-5% shall be done within a second time frame of 5 years, beginning from the third year from the date of coming into force of the Agreement. However, the period of subsequent tariff reduction by Sri Lanka shall be six years. Contracting States are encouraged to adopt reductions in equal annual installments**,** but not less than 15% annually. d) The subsequent tariff reduction by the Least Developed Contracting States from 30% or below to 0-5% shall be done within a second time frame of 8 years beginning from the third year from the date of coming into force of the Agreement. The Least Developed Contracting States are encouraged to adopt reductions in equal annual installments**,** not less than 10% annually. 2. The above schedules of tariff reductions will not prevent Contracting States from immediately reducing their tariffs to 0-5% or from following an accelerated schedule of tariff reduction. 3. a) Contracting States may not apply the Trade Liberalization Programme as in paragraph 1 above, to the tariff lines included in the Sensitive Lists which shall be negotiated by the Contracting States (for LDCs and Non-LDCs) and incorporated in this Agreement as an integral part. The number of products in the Sensitive Lists shall be subject to maximum ceiling to be mutually agreed among the Contracting States with flexibility to Least Developed Contracting States to seek derogation in respect of the products of their export interest…. Notwithstanding the provisions contained in paragraph 1 of this Article, the Non-Least Developed Contracting States shall reduce their tariff to 0-5% for the products of Least Developed Contracting States within a timeframe of three years beginning from the date of coming into force of the Agreement."

The number of items in the sensitive lists is a rough indicator of the extent to which trade liberalization is limited by the exclusion of items. This is shown in Table 8.[99] The background to SAFTA is low levels of intra-regional trade. In 1990, total intra-SAARC trade was 1.8 billion US dollars, increasing to 6.2 billion US dollars in 2000 and 29.9 billion US

[97] But beginning in 2013 for India and Pakistan, in 2014 for Sri Lanka and in 2016 for the LDCs. Once SAFTA takes off, the tariff rates for covered items will be between 0 and 5%.

[98] Article 7 of the SAFTA agreement.

[99] Reproduced from *Quantification of Benefits from Economic Cooperation in South Asia*, Asian Development Bank and United Nations Conference on Trade and Development and Macmillan, 2008.

dollars in 2008.[100] The intra-regional trade share was 2.91 in 1990, increasing to 4.28 in 2000 and 5.50 in 2008. The intra-regional trade intensity index was 3.03 in 1990, increasing to 4.05 in 2000 and 5.50 in 2008. These numbers are of course coloured by strong bilateral ties for some of the smaller economies, such as those between Bhutan-India, Maldives-Sri Lanka, Maldives-India and Nepal-India. There is a considerable amount of literature on the potential for intra-SAARC trade and interpreted as a classic free trade agreement (FTA) in manufactured products alone, there has been some skepticism about the potential, apart from a general point about FTAs being a trigger for and locking in trade policy reforms. Without reviewing the literature extensively[101], the grounds for skepticism are the following. First, the economies are complementary and scope for trade creation is limited. Second, liberalization will be circumvented by sensitive lists and rules of origin requirements. Third, liberalization will be circumvented by para-tariffs and non-tariff barriers. Fourth, there aren't effective and efficient dispute resolution mechanisms. Fifth, there is inadequate cooperation and agreement on trade facilitation, transit and transport connectivity. Sixth, there are supply rigidities in the smaller economies. Eighth, dynamic efficient gains of RTAs occur only if cross-border investments and cross-border trade in services are also included. Of these SAARC-skeptic arguments, the afore-mentioned UNCTAD-ADB study addresses the first by arguing that complementary across SAARC economies has increased over time, such as for textiles and garments and chemicals. It also exists for some agricultural products, usually kept outside the ambit of classic FTAs.

Table 8: Quantitative Importance of Sensitive Lists, 6-digit, HS

Country	No. of items for non-LDCs	No. of items for LDCs	Coverage of sensitive items as % of total, for non-LDCs	Coverage of sensitive items as % of total, for LDCs
Bangladesh	1254	1249	24.0	23.9
Bhutan	157	157	3.0	3.0
India	865	744	16.6	14.2
Maldives	671	671	12.8	12.8
Nepal	1335	1299	25.6	24.9
Pakistan	1191	1191	22.8	22.8
Sri Lanka	1079	1079	20.7	20.7

If one scans the list of existing global RTAs (regional trading agreements), one finds that they are essentially restricted to the FTA (free trade agreement) or customs union stage. This is understandable, since sentiments on free cross-border movements of labour are even stronger than sentiments on free cross-border movements of capital. Witness for example the issues of visas and illegal cross-border migration. While it is easy to argue that free labour movements should be allowed into developed countries, accepting the same logical proposition in one's own home country is not that simple. Currency unions also

[100] These figures are from the Asia Regional Integration Centre's integration indicators database, http://aric.adb.org/indicators

[101] Such a review exists in UNCTAD-ADB, *ibid.*

involve loss of national sovereignty, since one loses degrees of freedom over control of monetary, fiscal and exchange rate policy. Any multilateral, plurilateral, bilateral or regional agreement involves loss of sovereignty. Economic integration is difficult enough, but political integration even more so. And within economic integration, anything more than a FTA or customs union becomes exceedingly difficult, as the experiences of these other regional groupings demonstrate. The euphoria over SAARC's potential therefore needs to be diluted with a few doses of realism. Despite the report of the Group of Eminent Persons and the Integrated Programme of Action, that first-best solution of complete economic integration is simply too premature. One needs to look for second-best solutions. There are also systemic problems within the SAARC Secretariat.[102] It is tempting to look at Europe and cite the efficiency gains that have come about through regional integration. However, it is necessary to appreciate that these efficiency and welfare gains are consequent to industrial restructuring and have little to do with trade liberalization alone.

This becomes important in the context of what is accepted to be SAARC and SAFTA's eventual goal. The Islamabad Declaration stated, "We reiterate our commitment made at the 11th SAARC Summit at Kathmandu in January 2002 for the creation of a South Asian Economic Union. In this context, we underline that creation of a suitable political and economic environment would be conducive to the realization of this objective." The Dhaka Declaration added, "The launching of SAFTA would mark an important milestone on the road to a South Asian Economic Union….. The Heads of State or Government recognized the need to take the process of regional economic integration further by expanding the scope of SAFTA to include trade in services, enhanced investment and harmonized standards." In Islamabad, SAARCFINANCE was entrusted with the task of making recommendations for implementing a South Asian Economic Union (SAEU) and examining the concept of a South Asian Development Bank (SADB).

To go back to the quote from the Report of the SAARC Group of Eminent Persons, in its preparatory phase, SAARC had little to say on economic matters, even if that statement sounds a trifle uncharitable. In its expansionary phase, SAARC's economic efforts became synonymous with SAPTA/SAFTA, even though pronouncements have been made about trade in services, investment and finance, infrastructure, energy, environment, tourism, human resources and science, technology and meteorology. SAARC has been relatively irrelevant because of this equation with trade liberalization in manufactured products.

There are several reasons for this irrelevance. First, customs duties on manufactured products are increasingly irrelevant. They have been, and will be reduced, because of unilateral liberalization, apart from the DWP (Doha Work Programme) eventually resurfacing. Second, given this liberalization thrust, the timeline of 2016 is too long. Third, this liberalization will be circumvented by NTBs, standards, sensitive lists, rules of origin, safeguards, and anti-dumping, apart from issues of revenue compensation to LDCs.[103] Fourth, India is now a party (existing or proposed) to several other sub-regional RTAs – the Bay of Bengal Initiative for MultiSectoral Technical and Economic Cooperation (BIMSTEC)[104], Chile, Singapore, Thailand, ASEAN, Japan, South Korea, United States, EU, GCC, Andean Community, Brazil, South Africa, MERCOSUR, SACU, China, Afghanistan, Sri Lanka and Bangladesh are examples. These overtake SAFTA and also, strain the limited negotiating capacity and manpower resources Commerce Ministry possesses. Plus, they lead to

[102] This is over and above the processes. For instance, there are no technical persons in the technical committees. Nor is there any private sector representation.
[103] All these are built into the SAFTA agreement itself.
[104] Bangladesh, India, Myanmar, Sri Lanka, Thailand, Bhutan and Nepal, now rechristened as the Bay of Bengal initiative.

allegations of circumvention of rules of origin. Fifth, as is but obvious, any process of bloc formation has to be cross-subsidized by the larger country, in this case, India. Even if there is no actual cross-subsidization, the relative gains accrue more to smaller countries, theoretically, as well as empirically. If there is subsidization by India, should that be in the area of classic trade liberalization? Sixth, studies establishing the great potential that exists in free trade within South Asia are neither here nor there.[105] The results are tautological, since any process of liberalization will lead to welfare gains in a net sense. The key question to ask is, what are the trade liberalization gains within SAARC, as compared to trade liberalization gains with other parts of the globe, especially those parts that are economically more important – North America, Europe and ASEAN plus 3? Resources have opportunity costs. Seventh, as the focus of some of India's recent RTAs indicates, there is a need to move away from classic free trade agreements in manufactures to those in services (such as through comprehensive economic cooperation agreements), including agreements on freer cross-border movements of labour and capital. Does the existing SAARC trade agenda fit into this? Eighth, given the large and heterogeneous country that India is, is the idea of regional trade integration at all appropriate? Or does one have in mind economic integration between the southern parts of India and Sri Lanka and Maldives and between the eastern parts of India and Bhutan, Nepal, Bangladesh, Myanmar, Thailand and China? Or even between the northern parts of India and Pakistan[106]? Apart from the tactical intent, is there thus an economic rationale to sub-regional integration also? Should one therefore encourage direct interaction between India's States and neighbouring countries, rather than pushing everything at an all-India level? Ninth, in passing, one should go back to the figures on intra-SAARC trade.[107] As a percentage of total trade of the South Asian countries, the share has gone up a bit in the 1990s. But is that because of SAARC initiatives, or because the South Asian economies have become more outward-looking and less insular? If the increase is because of RTAs, is it because of SAPTA or because of bilateral trade agreements, the Indo-Sri Lanka FTA being a case in point?[108]

Having said this, if one looks at shares of India's exports and imports in the 1990s, the shares have gone up for Sri Lanka (particularly for imports from Sri Lanka) and Nepal. Bangladesh's share has declined. Bhutan has greater importance as an Indian export destination, but not as a source for imports, with the Bhutanese trend more or less replicated for Maldives and Pakistan. India's present trade pattern with the SAARC countries is shown in Table 9.[109] Post-reforms, the trade orientation of Indian manufacturing has increased. For public limited companies, the export/sales ratio increased from 9.7% in 1994-95 to 18.9% in 2006-07.[110] For private limited companies, it increased from 8.8% to

[105] This statement should not be interpreted as a dismissal of studies that estimate illegal cross-border trade between India on the one hand and say, Bangladesh, Sri Lanka and Pakistan on the other. But one must be careful. What goes by the name of illegal trade is sometimes third-country trade and actual cross-border illegal trade is not all of informal trade. And as the experience with Sri Lanka demonstrates, cross-border trade doesn't occur only because trade policy imposes customs duties. A large contribution is also due to high procedural costs associated with formal trade. See, for example, Nisha Taneja, "Informal Trade in the SAARC Region: Implications for FTAs," *Economic and Political Weekly*, 18 December 2004.

[106] Nor can one ignore the most favoured nation (MFN) issue between India and Pakistan. This means that Pakistan's imports from India are still governed by a positive list.

[107] Understandably, these figures exclude Afghanistan.

[108] In any event, shares can be somewhat misleading, because shares are also a function of what is happening to trade with other countries outside the bloc. For instance, an explosion in India's trade with China automatically reduces the SAARC share. Having said this, the shares also depend on whether one has a country like Nepal or Bhutan in mind, or whether one is talking about India. Understandably, intra-SAARC trade will be much more important to the former. And for India, especially if one is looking at Indian imports, one should net out the oil import component.

[109] Computed from DGCI&S, http://commerce.nic.in/eidb/default.asp

[110] *Economic Survey 2008-09*, Department of Economic Affairs, Ministry of Finance.

16.4%. An increasing amount of capital comes through FDI, ADRs/GDRs and external commercial borrowings (ECBs). Gross capital formation has increased and within manufacturing, FDI has come into sectors like automobiles, metallurgical industries and chemicals.[111] Not withstanding what was said earlier about constraints to competitiveness, Indian manufacturing has become a bit more competitive in some sectors, leading to a change in the export basket from light to heavy manufactures. Automobiles and auto ancillaries are a case in point and some restructuring has taken place, as a result of the reforms.

Table 9: Major Items in India's Exports and Imports, 2007-08

Country	India's exports	India's imports
Afghanistan	Man-made filaments, pharmaceutical products, electrical machinery, sugar, dairy produce	Edible fruit & nuts, lac & gum
Bangladesh	Cotton, vehicles, cereals, mineral fuels, sugar	Fish, salt, fertilizers, vegetable fibres, made-up textile articles
Bhutan	Vehicles, electrical machinery, iron & steel, boilers & machinery, mineral fuels	Animal & vegetable fats & oils, inorganic chemicals, iron & steel, copper
Maldives	Salt, iron & steel, electrical machinery, boilers & machinery, plastic	Iron & steel, copper, aluminum
Nepal	Mineral fuels, iron & steel, vehicles, cotton, cereals, pharmaceutical products	Coffee, animal & vegetable fats & oils, beverages, plastic, man-made staple fibres
Pakistan	Cotton, organic chemicals, inorganic chemicals, mineral fuels, plastic	Edible fruit & nuts, salt, mineral fuels, raw hides, cotton
Sri Lanka	Mineral fuels, vehicles, iron & steel, cotton, sugar	Ships & boats, animal & vegetable fats & oils, coffee, rubber, electrical machinery

To return to the classic trade liberalization agenda, arguments can be advanced about several components. First, the liberalization agenda can be fast-tracked, such as the offer of duty free access to LDCs by non-LDCs. This has already been done by India. Second, other than tariff quotas, anti-dumping measures and licensing requirements, most NTBs occur through standards.[112] There is thus a need to harmonize testing, certification and mutual recognition of standards. Third, as Table 10 shows, there can be sizeable gains from trade facilitation.[113] Fourth, there is a matter of trade and transit arrangements,

[111] *Ibid.*
[112] Both sanitary and phytosanitary measures (SPS) and technical barriers to trade (TBT).
[113] Reproduced from *South Asia Development and Cooperation Report 2008*, Research and Information System for Developing Countries and Oxford University Press, 2008.

between India-Bangladesh, India-Nepal, India-Bhutan, India-Pakistan, Bangladesh-Nepal, Bangladesh-Bhutan, Bhutan-Nepal and Pakistan-Afghanistan.[114] Fifth, the transport infrastructure is unsatisfactory – roads, railways, ports and shipping, inland waterways, civil aviation and even multi-modal. Sixth, moving away from classic trade liberalization, there is potential for liberalization and increased trade in services and even energy.[115] Seventh, the dynamic efficiency gains occur if cross-border investments are liberalized. India is a significant investor in both Sri Lanka and Nepal and Sri Lankan companies have also invested in India. These points are all valid. But given the India-Pakistan problems that cloud SAARC, are these initiatives best driven regionally or sub-regionally and bilaterally? The Bangkok Agreement and BIMSTEC have already been mentioned and India's RTAs will be listed separately. But that apart, Pakistan has a FTA with Sri Lanka and Bangladesh-Pakistan and Sri Lanka-Bangladesh FTAs are also likely. Given the problems, this seems to be a more promising option. This is despite some talk about the SAARC liberalization agenda now spilling over into cross-border investment and services.

Table 10: Expected Gains from Trade Facilitation (million US $)

	Port efficiency	Customs	Regulation	Service sector infrastructure	Total
Bangladesh	228	144	71	339	782
India	314	193	123	519	1149
Pakistan	74	29	42	191	336
Sri Lanka	97	63	41	175	377
South Asia	712	429	278	1224	2644

Section 7: Trade and investment flows between India and East Asia

In 2006-07, Asia and ASEAN accounted for 49.8% of India's exports of goods[116], compared to 22.9% for Europe and 19.2% for America. Of this, East Asia (excluding ASEAN) accounted for 1.2%, ASEAN for 10.0% (Singapore's share was 4.8%), the West Asia region for 18.2% (UAE had a share of 9.5%), North-East Asia for 15.3% (China had a share of 6.6%) and South Asia for 5.1% (Sri Lanka had a share of 1.8%). A perceptible trend since 2000-01 has been an increase in the importance of the East Asia region, especially with China included. For instance, in 2008-09, the last year for which provisional data on exports of goods are available, India's top five export destinations were UAE (share of 13.1%), USA (11.4%), China (5.1%), Singapore (4.5%) and Hong Kong (3.7%).[117] This is true not just of exports, but imports too. In imports, Asia and ASEAN accounted for 57.5% of India's imports of goods in 2006-07,[118] compared to 23.6% for Europe and 10.6% for America. Of

[114] These are bilateral.
[115] See respectively, UNCTAD-ADB and RIS, *ibid.*
[116] For April 2008 to February 2009, the share was even higher at 61.7%. Commerce Ministry, *Annual Report, 2008-09*, http://commerce.nic.in/publications/anualreport_chapter2-2008-09.asp.
[117] http://commerce.nic.in/ftpa/cnt.asp
[118] For April 2008 to February 2009, the share was even higher at 51.4%. Commerce Ministry, *Annual Report, 2008-09*, *ibid.*

this, East Asia (excluding ASEAN) accounted for 3.9% (Australia had a share of 3.6%), ASEAN for 9.5% (Singapore had a share of 2.9%, Malaysia of 2.8% and Indonesia of 2.2%), the West Asia region for 26.9%, North-East Asia for 16.5% (China had a share of 9.1%) and South Asia for 0.8% (Sri Lanka had a share of 0.3%). In 2008-09, the last year for which provisional data on imports of goods are available, India's top five import sources were China (share of 10.8%), UAE (7.1%), Saudi Arabia (6.7%), USA (6.2%) and Iran (4.2%).[119] Understandably, the import shares are affected by the presence of crude oil in imports.

Table 11 shows the importance of trade flows between India and East Asia, based on ADB indicators that drawn on IMF's direction of trade statistics.[120] The figures are for 2000 and 2008, with the 2000 numbers within brackets. The aggregate impression is that the export shares, import shares and trade shares of ASEAN, ASEAN+3, East Asia and East Asia 15 have increased significantly between 2000 and 2008. The disaggregated country-level figures show that these aggregates mask country-level differences. For instance, the shares have markedly gone up for China and Singapore and to a lesser extent for Korea, Indonesia (imports) and Thailand.[121] However, Japan's share has declined and that for several other countries has remained virtually unchanged. A trade intensity greater than one shows that the country's share is disproportionately high, compared to its share in world trade. Interpreted thus, the shares are high for Indonesia (also in 2000), Malaysia (also in 2000), Hong Kong (also in 2000), China and Singapore (to a lesser extent in 2000). However, they are low for Japan, Lao, Philippines and Cambodia. The apparent increase in trade relationships with East Asia is thus essentially a function of what has happened with Indonesia, Malaysia, Hong Kong, China, Singapore, and even Thailand.

Table 11: India's Trade Links with East Asia, 2000 and 2008

Country	Export share	Import share	Trade share	Trade intensity index
Korea	2.56 (1.07)	2.76 (1.96)	2.68 (1.56)	1.04 (0.63)
Japan	2.54 (4.15)	2.89 (4.00)	2.75 (4.07)	0.59 (0.62)
Indonesia	0.99 (0.91)	2.38 (1.83)	1.84 (1.41)	1.97 (1.83)
Philippines	0.27 (0.44)	0.10 (0.12)	0.17 (0.27)	0.35 (0.37)
Malaysia	1.20 (1.33)	2.47 (2.76)	1.98 (2.10)	1.55 (1.35)
Lao	0.00 (0.01)	0.00 (0.00)	0.00 (0.01)	0.14 (0.73)
Hong Kong	3.75 (6.12)	2.48 (1.68)	2.97 (3.71)	1.77 (1.96)
Cambodia	0.02 (0.02)	0.00 (0.00)	0.01 (0.01)	0.20 (0.36)
China	11.09 (1.78)	11.84 (2.88)	11.55 (2.37)	1.34 (0.51)
Thailand	1.23 (1.20)	1.23 (0.67)	1.23 (0.91)	1.12 (0.89)
Vietnam	0.75 (0.49)	0.08 (0.02)	0.33 (0.24)	0.79 (1.08)
Singapore	4.11 (1.94)	4.38 (2.94)	4.28 (2.48)	2.40 (1.40)
ASEAN	8.71 (6.45)	10.92 (8.70)	10.07 (7.67)	1.64 (1.24)
ASEAN+3	24.90 (13.45)	28.41 (17.55)	27.06 (15.67)	1.23 (0.79)
East Asia	21.18 (14.33)	20.97 (11.96)	21.05 (13.05)	1.10 (0.73)
East Asia 15	29.89 (20.77)	31.89 (20.66)	31.12 (20.71)	1.23 (0.86)

Table 12 is computed on the basis of Directorate General of Commercial Intelligence & Statistics (DGICS) sources and shows what India exports to and imports from East Asia.[122] This is for merchandise trade alone and for each country, we have shown the top five export

[119] http://commerce.nic.in/ftpa/cnt.asp
[120] Asian Regional Integration Centre, Integration Indicators Database.
[121] In 2000, a lot of exports directed towards Hong Kong were actually destined for China.
[122] http://commerce.nic.in/eidb/default.asp

and import items in terms of their values in the trade baskets, except when for a country values are so low that they do not warrant the mention of five items. The figures are for 2007-08. Since trade with these countries varies enormously in magnitude, one should not of course deduce that these trade flows are in any sense comparable across the East Asian countries shown in Table 12.

Table 12: Top-5 Items in India's Trade Basket with East Asia

Country	India's exports	India's imports
Brunei	Meat, edible vegetables, edible fruits & nuts, boilers & machinery, ores	Mineral fuels & oils, nothing else is significant
Cambodia	Pharmaceutical products, coffee & tea, cotton, boilers & machinery, raw hides & skins	Ships & boats, animal & vegetable fats & oils, oilseeds, coffee & tea, iron & steel
China	Ores, cotton, organic chemicals, copper, boilers & machinery	Electrical machinery, boilers & machinery, organic chemicals, iron & steel, mineral fuels & oils
Indonesia	Organic chemicals, iron & steel, mineral fuels & oils, animal fodder, cotton	Animal & vegetable fats & oils, mineral fuels & oils, ores, miscellaneous chemicals, organic chemicals
Japan	Mineral fuels & oils, pearls & precious stones, ores, marine products, animal fodder	Boilers & machinery, electrical machinery, vehicles, optical equipment, organic chemicals
Korea	Mineral fuels & oils, organic chemicals, iron & steel, copper, pearls & precious stones	Boilers & machinery, electrical machinery, mineral fuels & oils, iron & steel, vehicles
Lao	Boilers & machinery, pharmaceutical products, organic chemicals, iron & steel, man-made fibres	Lac & gum, electrical machinery, edible vegetables, wood
Malaysia	Mineral fuels & oils, copper, cereals, organic chemicals, boilers & machinery	Mineral fuels & oils, wood, animal & vegetable fats & oils, boilers & machinery, iron & steel
Myanmar	Pharmaceutical products, iron & steel, boilers & machinery, articles of iron & steel, vehicles	Edible vegetables & oils, wood
Philippines	Meat, rubber, oilseeds, vehicles, iron & steel	Mineral fuels & oils, iron & steel, paper, boilers & machinery, electrical machinery
Singapore	Iron & steel, electrical machinery, pharmaceuticals, plastic, meat	Mineral fuels & oils, organic chemicals, boilers & machinery, electrical machinery, ships & boats
Thailand	Pearls & precious stones, copper, mineral fuels & oils, animal fodder, organic chemicals	Boilers & machinery, electrical machinery, iron & steel, plastic, vehicles
Vietnam	Animal fodder, meat, iron & steel, cotton, plastic	Coffee, mineral fuels & oils, rubber

Until recently, FDI inflows from East Asia or ASEAN were relatively low. In 2005, cumulative FDI inflow from East Asia was 2.1 billion US dollars and that from ASEAN was 360 million, entirely from Singapore.[123] However, following the comprehensive economic cooperation agreement and the double tax avoidance agreement with Singapore in 2005, FDI inflows from Singapore have dramatically increased to 3.5 billion US dollars in 2008-09.[124] From 2000 to 2009, the cumulative stock of FDI from Singapore is 8.7 billion US dollars, the second highest after Mauritius. This is 8.7% of cumulative inflows. Japan has a cumulative inflow of 3.3 billion, or 3.4%. Cumulative inflows from both South Korea and Hong Kong are around 500 million US dollars, around 0.5%. Malaysia has 234 million (0.25%), Indonesia 72 million (0.08%), Thailand 55 million (0.06%) and China 14 million (0.02%)[125].

Till the agreements were signed in 2005, only 1644 Indian companies were registered in Singapore. But since then, an additional 2205 Indian companies have got registered. One reason behind the agreements with Singapore was discouragement of round-tripping versus Mauritius. Most FDI from Singapore has been in five sectors - telecommunications (17.93%), services (financial and non-financial) (16.28%), electrical equipment (including computer software and electronics) (12.4%), fuel (power and oil refining) (11.12%) and transportation (8.85%). The investments have come through government-linked companies in Singapore (Government of Singapore Investment Corporation, Monetary Authority of Singapore and Temasek Holdings) and individual companies like Flextronics. Investments through GIC and Monetary Authority of Singapore are direct, while those through Temasek Holdings are indirect, routed through Temasek-linked companies like Singapore Technologies Telemedia (STT). STT proposes to have investments in Idea Cellular and there are also investments in Bangalore-based Kshema Technologies and Chennai-based Softcraft India. Earlier, Singtel has investments in Bharti Televentures and a joint venture with Bharti Enterprises (for an undersea cable link between India and Singapore), but that was routed through Mauritius. GIC is now registered as a foreign institutional investor (FII) in India and there is a stake in HDFC. There is also the Ascendas Information Technology Park in Bangalore. GIC has stake in Edelweiss Capital and Anant Raj Industries. As mentioned, there have been few investments in manufacturing, which would have integrated Indian manufacturing into East Asian production chains. Perhaps the sole exception is GIC's investments in Reid and Taylor, a subsidiary of S. Kumars Nationwide.

Section 8: India's Trade Policy and FTAs

In this section, we turn to India's trade policy. Some elements of trade policy, those that involve unilateral responses (tariffs, quantitative restrictions, export incentives) have already been outlined. This section is thus about regional and multilateral responses and we have already mentioned the South Asia region.

In the Indian trade policy discourse, mention is often made of a Look East policy, which can even be dated back to 1991. But before that, it is worthwhile to have a list of India's RTAs and there is quite a spaghetti bowl there. This is given in Table 13.[126] For a country that earlier had only the Bangkok Agreement, and for several years a non-functional SAARC as an increment, this is an impressive list of RTAs. Given paucity of negotiating resources, is there any method and logical coherence in this madness, or are these RTAs

[123] Asian Regional Integration Database.
[124] http://dipp.nic.in/fdi_statistics/india_FDI_August2009.pdf
[125] There have been security concerns with some proposed Chinese FDI projects.
[126] Collated from Commerce Ministry information, http://commerce.nic.in/trade/international_ta.asp?id=2&trade=i

being tagged on in ad hoc fashion? At the risk of generalization, some assertions can be made. First, agreements centred around South Africa and Brazil are probably no more than attempts to cement negotiating coalitions at WTO. Second, there is implicit recognition that WTO negotiations are unlikely to head anywhere significant, even when DWP is "successfully" completed, since even a single country effectively has the right of veto. These RTAs will therefore be WTO-plus, such as in the area of services. At best, service sector liberalization within WTO will remain incomplete in the foreseeable future. Third, when services were first included in the Uruguay Round's agenda, India resisted the inclusion, perceiving this as a developed country attempt to over-load the agenda. Perceptions have changed and recognition has set in that India has a comparative advantage in services (this is much more than IT) and India's service sector liberalization agenda is much more than pushing for cross-border movements of labour. After all, FDI out of India is also considerable now and in selected service sectors, there are Indian interests in corporate presence abroad. This explains the switch in focus from conventional RTAs (which typically covered only goods and there too, manufactured products) to CECAs (comprehensive economic cooperation agreements), which also cover services and cross-border investments. Fourth, the role of RTAs in actually pushing greater trade is debatable, not in the sense that they are unimportant, but in the sense that government-negotiated RTAs probably do no more than put a legal stamp on increased trade flows that were in any case happening because of commercial reasons. NAFTA is a case in point. However, there is no denying that such negotiated RTAs provide a greater stimulus, since they also enhance mutual information flows and this is evident in closer links between India and ASEAN, or even East Asia in the broader sense. Incidentally, this also happens to be a high growth region. That East Asia should figure prominently in existing or potential RTAs isn't surprising. Fifth, there is recognition, usually left implicit, that the SAARC process is headed nowhere, SAFTA notwithstanding. The success of the FTA with Sri Lanka has been interpreted as vindication of the belief that sub-regional RTAs are the way to go. This splices in neatly with whatever is being done with East Asia – use sub-regional RTAs to bridge the distance between South Asia and East Asia. It is necessary to mention that India's existing RTAs are generally not under Article XXIV of GATT, but under the 1979 balance of payments enabling clause. Besides, there are those that cover services are under Article V of GATS (General Agreement on Trade in Services).

Table 13: India's RTAs

RTA	Partner countries	Status
SACU (South Africa Customs Union)	South Africa, Lesotho, Swaziland, Botswana, Namibia	Signing of PTA pending because of negotiations, eventual transition to FTA contemplated
Mercosur	Brazil, Argentina, Uruguay, Paraguay	Framework agreement signed in 2003, PTA signed in 2004
Chile	Chile	Framework agreement for economic cooperation in services and investment signed in 2005, PTA in 2006, FTA under examination. PTA in force from 2007.
IBSA CECA (Comprehensive Economic Cooperation Agreement)	Brazil, South Africa	Joint Study Group stage

RTA	Partner countries	Status
Trade and investment agreement (TIA) with EU	EU	Preliminary negotiations
CECA with Russia	Russia	Joint Study Group stage
GCC (Gulf Cooperation Council)	Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, UAE	Framework agreement for economic cooperation signed in 2004, ongoing negotiations for FTA, services and investments
Israel PTA	Israel	Ongoing negotiations
Comprehensive Economic Cooperation and Partnership Agreement (CECPA) with Mauritius	Mauritius	PTA, services and investment negotiations ongoing
Bangkok Agreement, now known as the Asia Pacific Trade Agreement	Bangladesh, China, South Korea, Sri Lanka, Laos	In existence since 1975, with exchange of tariff concessions. Third round of negotiations implemented in 2006.
BIMSTEC (Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation)	Bangladesh, Myanmar, Sri Lanka, Thailand, Bhutan, Nepal	Framework agreement for FTA, services and investments signed in 2004, negotiations ongoing
SAPTA/SAFTA	Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, Sri Lanka	SAFTA agreement in force from 2006
PTA with Afghanistan	Afghanistan	Signed in 2003, overtaken by SAFTA.
Trade agreement with Bangladesh	Bangladesh	Signed in 1980, not yet extended beyond 2001
Treaty of Trade with Nepal	Nepal	Renewed in 2007, annual quotas on four manufactured categories exported by Nepal
Trade and Commerce Agreement with Bhutan	Bhutan	FTA, extended in 2005, overtaken only partly by SAFTA.
FTA and CEPA (Comprehensive Economic Partnership Agreement) with Sri Lanka	Sri Lanka	FTA in force from 2000, CEPA awaiting signature
CECPA (Comprehensive Economic and Cooperation Partnership Agreement) with South Korea	South Korea	Ongoing negotiations on goods, services and investment
Economic Partnership Agreement (EPA) with Japan	Japan	Joint Task Force constituted

RTA	Partner countries	Status
Trade and economic cooperation with China	China	Joint Task Force and Joint Task Force stage
Trade and economic cooperation agreement with Mongolia, leading to CECPA	Mongolia	Signed in 1996, negotiations on CECPA ongoing
CECA with ASEAN	Brunei Darussalam, Cambodia, Indonesia, Lao, Malaysia, Myanmar, Philippines, Singapore, Thailand, Vietnam	Framework agreement signed in 2003, FTA signed in 2009, negotiations on services and investments pending
FTA and CECA with Thailand	Thailand	Under implementation from 2006, negotiations on services and investments ongoing
CECA with Malaysia	Malaysia	Negotiations ongoing since 2008
CECA with Singapore	Singapore	Implemented from 2005
CECA with Malaysia	Malaysia	Joint Study Group stage
CECA with Indonesia	Indonesia	Joint Study Group set up in 2007
FTA with Australia	Australia	Joint Study Group set up in 2008
FTA with New Zealand	New Zealand	Joint Study Group set up in 2008

From the regional and the bilateral, we now move on to the multilateral. This means the DWP and we will focus on issues India regards as important, without getting too much into the nitty-gritty. Since negotiations are about give and take, there will always be tensions and contentious haggling until a mutually acceptable agreement is hammered out. But once the controversial Singapore issues (investment protection, competition policy, transparency in government procurement and trade facilitation) were junked in Cancun 2003 and DWP's agenda was no longer over-loaded, the stumbling blocks remained NAMA (non-agricultural market access) and agriculture.[127] Even though one can mention services and rules (anti-dumping, subsidies), these haven't been stumbling blocks. This is not to deny that there are negotiating issues in these, such as the trade-offs between modes 1 (cross-border supply) and 4 (presence of natural persons) on one side and mode 3 (commercial presence) on the other in service sector negotiations. But these wouldn't have held up DWP. It boiled down to NAMA and agriculture.

NAMA also brings in issues connected to non-tariff barriers (NTBs). But let's leave those aside and focus on tariffs. In Hong Kong, it was decided that a Swiss formula would be used. A Swiss formula is non-linear, that is, there are proportionately higher reductions on higher levels of tariffs. Therefore, though indirectly, a Swiss formula also addresses problems of high tariffs, peak tariffs and tariff escalation.[128] However, building on a core

[127] Trade facilitation wasn't quite junked, but it wasn't as controversial as the other Singapore issues.

[128] High tariffs are when tariffs are high in general. Peak tariffs are when tariffs aren't in general high, but one particular tariff line has a high tariff. Tariff escalation occurs when tariffs increase as one goes up the value chain. A Swiss formula, so-named because the Swiss suggested it in the course of the Tokyo Round (1973-79), addresses high tariffs and to a lesser extent, peak tariffs. Tariff escalation is only addressed incidentally.

GATT principle, the NAMA mandate mentions "less than full reciprocity" for developing countries. How should this be interpreted? Is it enough to suggest that there should be a lower coefficient for developed countries and a higher one for developing countries? Or is it also about how far apart these two sets of coefficients are? This is complicated by negotiations concerning bindings and how many tariff lines can be left unbound, spliced with levels at which these bindings will occur. The greater the flexibility granted in keeping sensitive sectors out, the more likely a developing country is to accept lower coefficients in the Swiss formula. Yet another complication was caused by the introduction of what is called the sectoral initiative. The sectoral initiative was introduced with the best of intentions, aimed at supplementing the broad tariff reduction strategy. But as NAMA negotiations floundered on the question of coefficients, more and more sectors kept getting added and the sectoral initiative seemed about to supplant the general one. The NAMA packages that float around aren't packages India would have been happy with. However, no country would have been happy with the package. That is the hallmark of any good compromise agreement. But consider also the following. First, there is a considerable spread between bound rates and applied rates, apart from various other protective measures available (safeguards, anti-dumping). Second, unilateral liberalization and regional agreements have led to downward movement in manufactured tariffs. Third, even for unbound categories, the discomfort should be for petroleum products, not for urea or consumer goods or non-ferrous metals. Fourth, even when there is a reduction commitment, there will be enough flexibility in implementation periods. Binding or reduction commitments don't have to materialize overnight. There are negotiating postures one adopts to obtain concessions from trading partners. This is legitimate and understandable strategy. But beyond that, NAMA has never quite been an obstacle, from the Indian point of view.

On agriculture, following the Uruguay Round agreement, agricultural negotiations have followed the so-called three pillars of domestic support, market access and export competition. Market access means opening up markets. Since quantitative restrictions (QRs) are virtually non-existent for imports of agricultural products, opening up markets primarily means tariffs. There has been consensus for some time that there will be four tariff bands, with average tariff reductions varying across these bands. There has also been consensus that average tariff reductions will be lower for developing countries than for developed ones. The dispute has been over the precise numbers. In addition, not every tariff line need be subjected to such tariff reductions. For instance, developed countries can keep out some sensitive products and developing countries can keep out some special products. What percentage of tariff lines can be designated as special products? How are these special products to be identified? Should special products be subjected to some reduction or none at all? This has been the stuff of negotiations. In addition, over and above the overall safeguards clause, there was consensus that there should be a special safeguard mechanism (SSM) that would be available to developing countries. If there are significant agricultural imports, safeguards duties can be imposed. How high will these duties be? What will be the trigger for invoking the SSM clause? Will it be based on the volume of imports or the price at which imports take place? These have been controversial negotiating issues. Let's move on now to the domestic support issue. Not all domestic support to agriculture necessarily distorts trade. Hence, there is a concept of overall trade-distorting domestic support (OTDS).[129] Ideally, all OTDS should be scrapped. But that can, at best, be an end-point goal. No country is in a position to contemplate that, not even the developed countries. For instance, in EU, no substantial CAP (Common Agricultural Policy)

[129] There are technical details of amber box, blue box and *de minimis* support and how OTDS is computed. But we can ignore these for our purposes.

reform is possible before 2012. Hence, negotiations are about how much one can get the developed countries to reduce domestic support and how much reduction do developing countries have to accept in return? Finally, export competition used to be contentious, but is less so now.[130]

Given this, the following quote illustrates what India was after.[131] "Safeguarding the interests of India's low income and resource poor agricultural producers remains paramount for us. This cannot be traded off against any gains elsewhere in the negotiations. In this context, the following issues are vital: (1) Overall tariff reductions on bound rates of not more than 36%. (2) Self-designation of an appropriate number of Special Products guided by indicators based on the three fundamental and agreed criteria of food security, livelihood security, and rural development needs. The G-33 has proposed at least 20% agricultural tariff lines as Special Products, at least 1/2 of which must be exempted from any tariff cut. (3) An operational and effective Special Safeguard Mechanism to check against global price dips and import surges, which is more flexible than the existing safeguard mechanism available mainly to developed countries. The G-33 and India remain firm that a priori exclusion of any product, particularly SPs from the ambit of the SSM cannot be justified or accepted. Substantial and effective cuts in overall trade-distorting domestic support by US (70-75% cut) and by the EC (75%-80% cut), including resolving the issue of product-specific caps on AMS and in the new Blue Box."

There was no great controversy over export competition or export subsidies. Developed countries will eliminate scheduled export subsidies by the end of 2013, with budgetary outlays reduced in equal installments by 50% by the end of 2010. Numbers for the additional quantity commitments remained to be negotiated. Developing countries would have a timeline of 2016 in some instances and 2021 in others. Nor was there an insurmountable difficulty on domestic support and we are deliberately avoiding the nitty-gritty of issues connected with determination of the base period or AMS commitments, over and above the OTDS ones. In general, developing countries will have to achieve two-thirds of the reduction commitments accepted by developed countries. These reductions will be in nine steps over eight years. The two-thirds principle and the longer time-line followed principles enshrined in the Uruguay Round agreement on agriculture. Consequently, while one would have liked a faster or larger reduction in developed countries, this was qualified in at least three ways. First, a higher commitment by developed countries would also have required as *quid pro quo* a higher commitment by developing countries, even though the special and differential treatment clauses would be followed. Second, reduction or elimination of agricultural subsidies implies lower output and higher prices. Given global increases in food prices, net food importers weren't very keen that this should happen. Third, net food exporters had also imposed restrictions on agricultural exports. Consequently, pressures for domestic support reduction were probably not as intense as they had been three years ago in Hong Kong. Stated differently, this was perhaps not the best of times to push for agricultural liberalization.

Let us now move on to market access and we will gloss over issues of binding tariffs and reducing them to ad valorem equivalents, or issues of what was supposed to happen when there were tariffs in conjunction with quotas. The minimum average cut by developed

[130] Export competition is a more appropriate term than export subsidies, since there are other elements (export credit, export credit guarantees, insurance programmes, international food aid and State trading) can also have subsidy-like effects. There is already an agreement to the effect that developed countries must eliminate some export subsidies by the end of 2013, with at least half by 2010. Developing country commitments still remain a subject for negotiation.

[131] *India and the WTO,* Vol. 9-10, November 2007-January 2008, http://commerce.nic.in/publications/india_wto_newsletter.asp?id=1#44

countries will be 54%. The maximum average cut by developing countries will be 36%. Everything need not be subjected to these reduction commitments. For instance, developed countries can keep out sensitive products, although the percentage of tariff lines that could be designated as sensitive products remained to be re-negotiated. In similar vein, developing countries have recourse to special products (SPs). There was a more serious problem with SPs than with export competition, domestic support or market access in general. There was also a problem with the special safeguard mechanism (SSM). On SSM, the problem was with the precise numbers in the price and volume triggers that would warrant usage of SSM. One can't lose sight of a few core fundamentals. First, Indian agriculture has been in bad shape and agriculture remains important, notwithstanding the declining contribution of agriculture in sectoral composition of GDP or employment. While the reasons for this malaise have little to do with WTO and external sector liberalization, there is a perception that trade liberalization has contributed to problems. Policies are framed not just on facts, but perceptions too. Second, Indian agriculture may be price competitive in general, although India remains a marginal player still in agricultural exports. However, there are sectors like edible oils, dairy and poultry where India isn't price competitive yet. In an overall macro sense, these may not be that quantitatively important. However, in a geographical and regional sense, there are areas where these are important crops. Adjusting and moving away from price uncompetitive areas is easier said than done. Therefore, it is understandable that Commerce Ministry should be wary of market access commitments without sufficient safeguards. At a slightly superficial level, the DWP impasse was because of a disagreement between India and the US over SSM. Though superficial, this impression has a grain of truth in it. In September 2009, a "mini-Ministerial" has been held in Delhi. Though it is early days yet, there are some signs that India may have weakened its hard line on SSM and if that is indeed the case, the prospects for DWP have improved.

Section 9: Concluding Remarks and Institutions

To return to East Asia and ASEAN, the FTA between India and ASEAN is in a way the first multilateral FTA that India has signed, if one ignores SAPTA/SAFTA. This was eventually signed in August 2009, after negotiations were stuck for six years on India's sensitive and negative lists. The signed FTA contemplates tariff reductions from January 2010 to December 2016, with an intermediate step in December 2013. Indian protectionist sentiments were especially evident in products like palm oil, tea, coffee and pepper.[132] But other than agriculture, even now, automobiles, auto ancillaries, machinery, chemicals, crude oil and textiles are excluded. Had that not been the case, ASEAN might have been willing to extend the FTA to cover software, information technology and tourism. As of now, India's economic relationships with ASEAN are primarily with Singapore, Malaysia and Thailand. As the agreement with Singapore demonstrates, to take these relationships to a different plane and broad-base them across ASEAN countries, there need to be agreements on services and investments. These negotiations have now started and are due to be completed by December 2009. Once these negotiations are completed, the question that needs to be asked is – what institutions are likely to take the relationship between India (and South Asia) and East Asia forward?

Some idea of the institutions can be gleaned from the framework agreement that was signed between India and ASEAN in 2003.[133] Article 6.1 stated, "Where appropriate, the Parties agree to strengthen their cooperation in the following areas, including, but not

[132] There were protectionist sentiments in Indonesia and Malaysia too.
[133] http://commerce.nic.in/trade/international_ta_framework_asean.asp

limited to: Trade Facilitation: Mutual Recognition Arrangements, conformity assessment, accreditation procedures, and standards and technical regulations; non-tariff measures; customs cooperation; trade financing; and business visa and travel facilitation. Sectors of Cooperation: agriculture, fisheries and forestry; services: media and entertainment, health, financial, tourism, construction, business process outsourcing, environmental; mining and energy: oil and natural gas, power generation and supply; science and technology: information and communications technology, electronic-commerce, biotechnology; transport and infrastructure: transport and communication; manufacturing: automotive, drugs and pharmaceuticals, textiles, petrochemicals, garments, food processing, leather goods, light engineering goods, gems and jewellery processing; human resource development: capacity building, education, technology transfer; and others: handicrafts, small and medium enterprises, competition policy, Mekong Basin Development, intellectual property rights, government procurement. Trade and Investment Promotion: fairs and exhibitions; India-ASEAN weblinks; and business sector dialogues." Article 11.1 added, "The Parties shall, within one (1) year after the date of entry into force of this Agreement, establish appropriate formal dispute settlement procedures and mechanism for the purposes of this Agreement." Finally, Article 12 stated, "There shall be established an ASEAN-India Trade Negotiating Committee (TNC) to carry out the programme of negotiations set out in this Agreement. The ASEAN-India TNC may invite experts or establish any Working Group as may be necessary to assist in the negotiations of all sectors in the India-ASEAN RTIA. The ASEAN-India TNC shall regularly report to the Minister of Commerce and Industry of India and the ASEAN Economic Ministers (AEM-India Consultations), through the meetings of the ASEAN Senior Economic Officials and India (SEOM-India Consultations), on the progress and outcome of its negotiations. The Ministry of Commerce and Industry, Government of India, and the ASEAN Secretariat shall jointly provide the necessary secretariat support to the ASEAN-India Trade Negotiating Committee (TNC) whenever and wherever negotiations are held."